S. Hrg. 101-868, Vol. II

THE ABUSE AND MISMANAGEMENT OF HUD

HEARINGS

BEFORE THE

HUD/MOD REHAB INVESTIGATION
SUBCOMMITTEE

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

ON

VOLUME II OF II

APRIL 20, 1990—HUD'S STAFFING AND ORGANIZATIONAL CAPACITY

APRIL 23, 1990—EXECUTIVE AND OMB OVERSIGHT OF HUD

APRIL 27, 1990—LOW-INCOME HOUSING TAX CREDITS

MAY 8, 1990—CONGRESSIONAL OVERSIGHT OF HUD

MAY 16, 1990—REBUILDING OF HUD

JUNE 29, 1990—HUD IG AND SECRETARY'S SEMI-ANNUAL REPORTS

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE
31-599 WASHINGTON : 1990

S241-56

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

DONALD W. RIEGLE, Jr., Michigan, *Chairman*

ALAN CRANSTON, California
PAUL S. SARBANES, Maryland
CHRISTOPHER J. DODD, Connecticut
ALAN J. DIXON, Illinois
JIM SASSER, Tennessee
TERRY SANFORD, North Carolina
RICHARD C. SHELBY, Alabama
BOB GRAHAM, Florida
TIMOTHY E. WIRTH, Colorado
JOHN F. KERRY, Massachusetts
RICHARD H. BRYAN, Nevada

JAKE GARN, Utah
JOHN HEINZ, Pennsylvania
ALFONSE M. D'AMATO, New York
PHIL GRAMM, Texas
CHRISTOPHER S. BOND, Missouri
CONNIE MACK, Florida
WILLIAM V. ROTH, Jr., Delaware
NANCY LANDON KASSEBAUM, Kansas
LARRY PRESSLER, South Dakota

Steve B. Harris, *Staff Director and Chief Counsel*
Lamar Smith, *Republican Staff Director and Economist*

HUD/Mod Rehab Investigation Subcommittee

BOB GRAHAM, Florida, *Chairman*

RICHARD C. SHELBY, Alabama
RICHARD H. BRYAN, Nevada

CONNIE MACK, Florida
CHRISTOPHER S. BOND, Missouri

Talbot D'Alemberte, *Chief Counsel*
Jim Watt, *Minority Special Counsel*
William Leary, *Staff Director*
Kathy Momot, *Chief Clerk*

CONTENTS

VOLUME II OF II

TUESDAY, JANUARY 30, 1990

THE MISSION OF HUD

Page

Opening statement of Senator Graham 1
  Prepared statement 2
Opening statement of Senator Riegle 2
  Prepared statement 3
Prepared statement of Senator Mack 4
Prepared statement of Senator Shelby 5

WITNESSES

Robert Weaver, former Secretary, Department of Housing and Urban Development, professor emeritus of urban affairs, Hunter College, City University of New York; and Robert Wood, former Secretary, Department of Housing and Urban Development, the Henry R. Luce, professor of democratic institutions and the social order, Wesleyan University, Middletown, CT 6
  Prepared statement 8
Richard Van Dusen, former Under Secretary, Department of Housing and Urban Development, chairman, Dickinson, Wright, Moon, Van Dusen & Freeman, Detroit, MI 21
  Prepared statement 23
John Rhinelander, former Under Secretary, Department of Housing and Urban Development, partner, Shaw, Pittman, Potts & Trowbridge, Washington, DC 25
  Prepared statement 27
Philip Brownstein, former Federal housing commissioner, senior partner, Brownstein, Zeidman and Schomer, Washington, DC 33
  Prepared statement 35
Anthony Downs, senior fellow in economics, The Brookings Institute, Washington, DC 52
  Prepared statement 55
Rudolph Penner, senior fellow, The Urban Institute, Washington, DC 66
  Prepared statement 68

TUESDAY, FEBRUARY 27, 1990

THE ANATOMY OF A DEAL

Opening statement of Senator Graham 87
  Prepared statement 88
Opening statements of:
  Senator Mack 88
  Senator Bryan 98

WITNESSES

Page
Richard Baron, president, McCormack Baron and Associates, St. Louis, MO 88
Thomas P. Costello, senior vice president, property management, MBA Realty, St. Louis, MO 97
Philip Abrams, Philips Development, Engelwood, CO 115
Joseph M. Queenan, J. Michael Queenan Associates, Inc., Denver, CO 116
Tom Coe, vice president, Benton Mortgage Co., Knoxville, TN 116
William Tanker, vice president of underwriting, Benton Mortgage Co., Knoxville, TN 118
  Prepared statements [Joint] 119
  Response to written questions of Senator Riegle 282
William Cottrell, executive director, Clark County Housing Authority, Clark County, Las Vegas, NV 137
  Prepared statement 141
  Letters related to testimony:
    March 9, 1990 175
    June 1, 1990 176
John Ols, Director of Economic and Community Development Issues, U.S. General Accounting Office, Washington, DC 146
  Prepared statement 150

AFTERNOON SESSION

Marilyn Melkonian, president, Telesis Corp., Washington, DC 185
  Prepared statement 189
Karen Kollias, vice president of community development lending group, American Security Bank, Washington, DC 201
  Prepared statement 204
Sheldon Baskin, attorney, Chicago, IL 221
  Prepared statement 223
Patrick E. Clancy, executive director, The Community Builders, Boston, MA 245
  Prepared statement 250

TUESDAY, MARCH 27, 1990

COINSURANCE

Opening statement of Senator Graham 333
Opening remarks of Senator Mack 335
  Complete prepared statement of Senator Mack 336

WITNESSES

George Hipps, Senior Vice President, PW Funding, Inc., Washington, DC 338
  Prepared statement 465
Gaye G. Beasley, Member, Board of Governors, Mortgage Bankers Association, Washington, DC 339
  Prepared statement 480
Larry Dale, Senior Vice President, Multifamily Finance and Housing Initiatives, Federal National Mortgage Association, Washington, DC 341
  Prepared statement 498
Warren Lasko, Executive Vice President, Mortgage Bankers Association, Washington, DC 342
  Prepared statement 512
Peter H. Monroe, General Deputy Assistant Secretary of Housing, Department of Housing and Urban Development, Deputy Federal Housing Commissioner, Washington, DC 347
  Prepared statement 518
Alfred DelliBovi, Under Secretary, Department of Housing and Urban Development, Washington, DC 345
  Prepared statement 538
Professor Robert Edelstein, Center for Real Estate and Urban Economics, University of California at Berkeley, Berkeley, CA 348
  Prepared statement 546
Thomas Craren, Partner, Price Waterhouse, Washington, DC 433
  Prepared statement 557
Chris Greer, Assistant Inspector General for Audit, Department of Housing and Urban Development, Washington, DC 437
  Prepared statement 563

Page
Robert P. Kalish, Executive Vice President, Government National Mortgage Association, Washington, DC ... 451
John Baecker, Former President and Chief Underwriter, United Guaranty Commercial Insurance Company, Greensboro, NC ... 581

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

Mortgage Bankers Association of America:
  Recommendations on bankruptcy law reform ... 591
  Letter from Senator Graham to Gaye Beasley and Warren Lasko dated April 12, 1990 ... 596
  Response to letter from Senator Graham ... 598
  Charts:
    Chart A.—Defaulted Coinsured Loans ... 600
    Chart B.—Section 223(f) ... 601
    Chart C.—Section 221(d) ... 602
    Chart D.—Illustration of how FHA's multifamily coinsurance and GNMA's MBS programs work together ... 603
    Chart E.—Compliance with coinsurance program requirements ... 604
    Table 2.—Coinsurance defaults and claims as of August 31, 1989 ... 605
    Concentration of risk among the largest coinsurers ... 606

WEDNESDAY, APRIL 18, 1990

PAST AND PRESENT HUD MANAGEMENT: MATERIAL WEAKNESSES

Opening statement of Senator Graham ... 607
Opening statement of Senator Mack ... 609

WITNESSES

Paul Adams, Inspector General, Department of Housing and Urban Development, Washington, DC; accompanied by Chris Greer, assistant inspector general for audit, HUD; and James Martin, director of planning and administration, Office of Audit, HUD ... 609
  Prepared statement ... 612
    Internal management controls ... 614
    Financial management systems ... 615
    Summary ... 616
      Summary of results, 1983 ... 617
      Summary of results, 1984 ... 619
      Summary, 1985 ... 622
      Executive summary, 1986 ... 623
      Executive summary, 1987 ... 624
      Executive summary, 1988 ... 626
Alfred DelliBovi, Under Secretary, Department of Housing and Urban Development; accompanied by Harold Henry, director, Office of Management and Quality Assurance, HUD; Janice Combs, director, Financial Management Systems, Office of Finance and Accounting, HUD ... 639
  Prepared statement ... 642
    Introduction ... 642
    General financial management improvements ... 642
    Specific improvements made in internal controls program ... 644
    Conclusion ... 648
Donald Chapin, Assistant Comptroller, Accounting and Financial Management Division, U.S. General Accounting Office; accompanied by Jeffrey Steinhoff, Director, Financial Management Issues and Audits, GAO; and John Ols, Jr., Director, Housing and Community Development Issues, GAO. 663
  Prepared statement ... 667
    Weak internal control systems exist throughout the Government ... 669
    Financial management systems are weak and improvements are slow, costly, and often ineffective ... 671
    A strong work force is needed to meet current and future challenges.. 672
    Actions needed to strengthen controls and accounting systems ... 673
    GAO's "High Risk" program ... 682
    GAO testimony of Dennis J. Duquette, dated September 13, 1989 ... 687

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

Page

Chart A.—HUD's most serious existing material weaknesses, 1989 FMFIA Report 712

Chart B.—How HUD compiles its annual FMFI reports 715

Letter dated December 31, 1987, to the White House, from Samuel R. Pierce, Jr 716

Letter dated December 29, 1989, to the White House, from Jack Kemp [Without enclosures] 720

U.S. Senate HUD Mod Rehab Investigation, April 8, 1990, hearing response from Watson Rice and Co., CPA's 733

VOLUME II OF II

FRIDAY, APRIL 20, 1990

STAFFING AND ORGANIZATIONAL CAPACITY

Opening statement of Senator Graham 1
Opening statement of Senator Mack 2

WITNESSES

George O. Hipps, vice president, P.W. Funding Mortgage Co., Washington, DC 3
    Prepared statement 5
Alfred Kliman, Director, Office of Budget, Department of Housing and Urban Development 13
Walter Sevier, Deputy Regional Administrator, Fort Worth Regional Office, Department of Housing and Urban Development, Fort Worth, TX 13
Marvin Siflinger, executive director, Massachusetts State Housing Finance Agency, Boston, MA, on behalf of National Council of State Housing Finance Agencies 28
Daniel, Grady, president, The Monfric Corp., San Diego, CA, on behalf of National Assisted Housing Management Association 30
    Prepared statement 33
John Koelemij, president, Orange State Construction Co., Tallahassee, FL, on behalf of National Association of Home Builders 38
    Prepared statement 41
Brian Chappelle, staff vice president for residential finance/government agency relations, Mortgage Bankers Association, Washington, DC 46
    Prepared statement 48
Dwight Ink, president, Institute for Public Administration, New York, NY 72
    Prepared statement 76

Additional Material Supplied for the Record

Letter to Senator Graham, dated May 15, 1990, from WWH Properties, Inc., Paul B. Hazlett, president 99

MONDAY, APRIL, 23, 1990

EXECUTIVE AND OBM OVERSIGHT OF HUD

Opening statement of Senator Graham 105
Opening statement of Senator Mack 106

WITNESSES

Anne Banning, former Assistant Director, Office of Presidential Personnel; Charles Dutcher, former Assistant Director, Office of Presidential Personnel; and Mark Robbins, former Deputy Assistant Director, Office of Presidential Personnel 106
William Diefenderfer, Deputy Director, Office of Management and Budget, Washington, DC 134
    Past OMB Budget/management oversight of HUD 135
    Actions taken specific to HUD 135
    Current OMB management integrity program 137

Page
William Diefenderfer, Deputy Director, Office of Management and Budget, Washington, DC—Continued
  Future plans for OMB management oversight 137
  Conclusion 138
  Questions sent by Senator Graham 205
  Response to written questions 208
Frank Hodsoll, Executive Associate Director for Management, Office of Management and Budget, Washington, DC 139
Hugh Heclo, Clarence J. Robinson Professor, George Mason University, Fairfax, VA; former consultant to the President's Reorganization Project, Office of Management and Budget 162
  Prepared statement 166
Alan Dean, former senior management analyst at Bureau of the Budget; former Deputy Associate Director, Office of Management and Budget 184
  Prepared statement [Joint] 189
Harold Seidman, guest scholar, Center for the Study of American Government, Johns Hopkins University, Washington, DC; former Assistant Director for Mangement and Organization, Bureau of the Budget 187
  Prepared statement [Joint] 189

Additional Material Supplied for the Record

Institute of Public Administration, additional testimony of Dwight Ink, president 218
National Academy of Public Administration:
  Statement of the Standing Panel on Executive Organization and Management, by Alan L. Dean, president 230
  Report entitled "Revitalizing Federal Management": managers and their overburdened systems, November 1983 [Chapters 1 and 2 only] 252

FRIDAY, APRIL 27, 1990

LOW-INCOME HOUSING TAX CREDITS

Opening statement of Senator Graham 265
Opening statement of Senator Mack 267

WITNESSES

John M. Ols, Director, Housing and Community Development Issues, U.S. General Accounting Office, Washington, DC, accompanied by Dennis Fricke, Assistant Director 268
  Prepared statement 273
    Program background and tax credit utilization, 1987-89 275
    Syndicating low-income housing and the effect of passive activity rules 277
    Syndication structures vary widely 279
    Costs associated with syndicating tax credits 280
    Tax expenditure used to attract private investor capital 281
    Transaction costs for public offerings 283
    Direct corporate placements 285
    Conclusions 286
    Attachment I.—National summary of tax credit activity 289
    Attachment II.—State summary of tax credits usage in CY 1989 290
    Attachment III.—State summary of tax credits usage in CY 1988 292
    Attachment IV.—State summary of tax credits usage in CY 1987 294
    Attachment V.—Tax credit project syndication flow chart 296
William E. Haynsworth, Senior Vice President, the Boston Financial Group Inc., Boston, MA 303
  Prepared statement 335
Barton Harvey III, Deputy Chairman, the Enterprise Foundation, Columbia, MD 304
  Prepared statement 355
John Weicher, Assistant Secretary for Policy Development and Research, Department of Housing and Urban Development, Washington, DC accompanied by Fred Eggers, Associate Deputy Assistant Secretary for Economic Affairs 304
  Prepared statement 391

WEDNESDAY, MAY 16, 1990

REBUILDING OF HUD

Page
Opening statement of Senator Graham 581
Opening statement of Senator Mack 582
Opening statement of Senator Riegle 584

WITNESS

Jack Kemp, Secretary, Department of Housing and Urban Development, accompanied by Alfred A. DelliBovi, Under Secretary, and Frank Keating, General Counsel, United States Department of Housing and Urban Development 586
- Prepared statement 593
  - Scope of the problem 595
  - Management actions 597
  - Relationship with Congress 599
- Response to written questions of Senator Graham 765

FRIDAY, JUNE 29, 1990

HUD IG AND SECRETARY'S SEMI-ANNUAL REPORTS

Opening statement of Senator Graham 627
Opening statement of Senator Mack 628

WITNESSES

Paul Adams, Inspector General, Department of Housing and Urban Development, accompanied by Chris Greer, Assistant Inspector General for Audits and Patrick Neri, Assistant Inspector General for Investigations 629
- Prepared statement 634
  - The semi-annual report 636
  - Overview of major problems 636
  - Audit 638
  - Management response to audits 646
  - Investigation 647
  - Significant investigations 649
  - Closing agent cases prosecuted 650
  - Prevention 652
  - HUD staffing resources 654
- Response to written questions of Senator Graham 726

Alfred DelliBovi, Under Secretary, Department of Housing and Urban Development, accompanied by Lloyd Chaisson, Senior Advisor 664
- Prepared statement 669
  - Introduction 669
  - Staffing 671
  - Monitoring 672
  - Training 673
  - FHA closing agents 675
  - Retirement service centers 676
  - Conclusion 678
- Response to written questions of Senator Graham 747

Paul Maloney, Deputy Assistant Attorney General, Criminal Division, Department of Justice 688
- Prepared statement 690
- Additional material supplied for the record 775

John Keeney, Deputy Assistant Attorney General, Criminal Division, Department of Justice 699
- Prepared statement 700

Frank Keating, General Counsel, Department of Housing and Urban Development 704
- Prepared statement 707

Page
Mark Hendrickson, [Representing the National Council of State Housing Agencies] Executive Director, Florida Housing Finance Agency, Tallahassee, FL 305
  Prepared statement 404
  Appendix to prepared statement 750
David Blattner, Assistant Commissioner for Examination, Internal Revenue Service, Washington, DC, accompanied by Susan Reaman, Assistant Branch Chief, Chief Counsel's Office 306
  Prepared statement 431
  Charts:
    1. Tax credits allocated 440
    2. Tax credits use with other subsidies 441
    3. Source of other subsidies used with tax credit 442
    4. The tax credit user 443
    5. Appropriations for major subsidy programs which can be used with tax credit 444
    6. Appropriations for major components of the section 8 program 445
James Logue, Deputy Assistant Secretary for Multifamily Housing, Department of Housing and Urban Development, Washington, DC 311

TUESDAY, MAY 8, 1990

CONGRESSIONAL OVERSIGHT

Opening statement of Senator Graham 447
Opening statement of Senator Mack 488

WITNESSES

Paul A. Adams, Inspector General, Department of Housing and Urban Development, Washington, DC 448
  Prepared statement 451
  Response to written questions of Senator Graham 550
Charles L. Dempsey, Former Inspector General, Department of Housing and Urban Development, Washington, DC 460
Frederick M. Kaiser, Specialist in American National Government, Congressional Research Service, The Library of Congress, Washington, DC 460
  Prepared statement 465
    Current statutory offices of Inspector General 467
    Reporting to the Attorney General 469
    Reporting to the establishment head and Congress 470
    Options for improving IG reporting and Congressional oversight 473
  Response to written questions of Senator Graham 556
Richard L. Fogel, Assistant Comptroller General, General Government Division, U.S. General Accounting Office, Washington, DC 492
  Prepared statement 495
  Response to written questions of Senator Graham 568
Stanley M. Brand, Brand & Lowell, Washington, DC 503
Richard A. Wegman, Garvey, Schubert & Barer, Washington, DC, on behalf of the National Academy of Public Administrators 505
  Prepared statement 508
    The challenges of effective oversight 509
    NAPA congressional oversight panel recommendations 511
    Preventing HUD's by getting capable, qualified management 511
    Changing congressional behavior 514
    Recommendations 517
Thomas E. Mann, Director, Government Studies Program, the Brookings Institution, Washington, DC 520
  Prepared statement [Joint] 523
Bert A. Rockman, Senior Fellow, Governmental Studies Program, the Brookings Institution, Washington, DC 519
  Prepared statement [Joint] 523
  Response to written questions of Senator Graham 577

HUD'S STAFFING AND ORGANIZATIONAL CAPACITY

VOLUME II OF II

FRIDAY, APRIL 20, 1990

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
HUD/MOD REHAB INVESTIGATION SUBCOMMITTEE,
Washington, DC.

The subcommittee met at 10:06 a.m., in room SD–538 of the Dirksen Senate Office Building, Senator Bob Graham (chairman of the subcommittee) presiding.

Present: Senators Graham, and Mack.

OPENING STATEMENT OF SENATOR GRAHAM

Senator GRAHAM. I call the meeting to order.

I extend our best wishes to all of the participants today, and we look forward to a very interesting and instructive hearing.

Today, we resume our hearings into the abuse and mismanagement at the Department of Housing and Urban Development.

Throughout the course of the previous congressional hearings, several witnesses have testified that a key factor which contributed to the mismanagement of HUD was the agency's inability to effectively monitor and administer its programs and operations. Lack of adequate staffing resources has been cited as a key component of that problem.

The Reagan administration's reduced emphasis on housing programs and corresponding budget cuts left HUD with only a bare bones staff. The agency suffered from deferred maintenance as budget cuts, staffing freezes and lack of interest in managing at the top of the organization systematically undermined the agency's ability to function.

The intent of this inquiry is to identify the staffing and organizational capacity problems the agency has experienced, the causes of those difficulties and the corrective actions that must be taken.

We will be hearing from three panels which can help shed light on these questions.

The first panel will consist of former and current senior career officials. These officials have each spent a significant portion of their professional lives working for HUD and are dedicated to carrying out the mission of the agency.

As part of the organization's institutional memory, they will be asked to provide their insights into how the agency has changed over time and how this has impacted staffing.

The second panel will consist of representatives from various trade associations whose memberships do business with HUD. They will be asked to comment on the difficulties in trying to work with HUD to produce and manage housing.

Our final panel will be an individual who is an expert in the area of human resources and organizational management, who, coincidentally, was HUD's first Assistant Secretary for Administration. He will comment on how the organizational structure of HUD has contributed to management difficulties.

My colleague and the ranking member of the subcommittee, Senator Mack.

OPENING STATEMENT OF SENATOR MACK

Senator MACK. Thank you, Bob.

Our focus on HUD staffing brings this subcommittee to the halfway point toward the completion of its hearings. I would like to thank today's witnesses for their participation and I look forward to hearing their testimony.

I think we all agree that competent staff and sufficient budgeting for this purpose is central to the implementation of a sound housing policy. Secretary Jack Kemp has done a fine job of surrounding himself with bright people who care about housing. I believe this is due in large part to the attractiveness of Mr. Kemp's positive new ideas for empowering the poor.

Given the complexity and pervasiveness of the problems at HUD, I believe we should always look at specific problems, such as staffing, in the broader context of our overall housing policy and the programs we design for its delivery. Staff is empowered to implement housing policy. Without sound housing policy, it is unrealistic to expect staff to run programs efficiently and successfully. It is also unrealistic to expect HUD to attract good staff if it is plagued by programs that do not work.

We in Congress have a responsibility to provide staff with programs that work, that is, programs that allow the most efficient method of providing housing assistance to the needy. Many of HUD's programs have failed in this regard. It seems that everyone I speak with involved with housing in Florida tells me HUD programs are overly complicated and if they need HUD funding, they are forced to hire a consultant. This is a wasteful and inefficient method of assisting the poor.

This subcommittee was created to examine what went wrong at HUD. In doing so, I hope we keep in mind the broader perspective of general housing policy as we look at problems such as staffing at HUD.

I think we all agree that competent staff and sufficient budgeting for this purpose is central to the implementation of a sound housing policy.

Secretary Kemp has done a fine job of surrounding himself with bright people who care about housing. And I believe that this is due in large part to the attractiveness of Mr. Kemp's positive ideas for empowering the poor.

And I guess what I'm saying there is that I don't think there's any question about dollars are important in encouraging people to participate in government and housing programs. But, I think also that there's another element, and that is the commitment of the person at the top, the enthusiasm, the excitement that individual has for the job that he or she is involved in. And I think that enthusiasm for trying to solve the Nation's problems with respect to housing is something that is, in fact, exemplified by Jack Kemp's participation. And I think that has had an impact on the quality of people, at least that I have dealt with so far at HUD.

So I look forward to your testimony, and I appreciate your being here this morning.

Senator GRAHAM. Thank you, Senator.

The first panel represent individuals with professional background in the Department. Our first speaker will be Mr. George Hipps, who is now vice president of P.W. Funding Mortgage Co., Washington.

Mr. Hipps.

STATEMENT OF GEORGE O. HIPPS, VICE PRESIDENT, P.W. FUNDING MORTGAGE CO., WASHINGTON, DC

Mr. HIPPS. Thank you, Mr. Chairman, Senator Mack.

I have submitted a prepared statement and I would ask that that be put into the record. And I would just like to make an opening comment.

Senator GRAHAM. Mr. Hipps, if you would excuse me, I neglected to swear all of the witnesses, which has been a standard of the Banking Committee.

Would those members of each of the three panels who are going to testify today please stand?

[All witnesses sworn.]

Senator GRAHAM. I apologize, Mr. Hipps.

Mr. HIPPS. Thank you, Mr. Chairman.

My purpose here today and my concern is primarily with respect to the continued availability of the HUD/FHA programs of mortgage insurance, particularly for multifamily rental and health care facilities.

I think the delivery of these programs is in serious jeopardy because of the inability of HUD to handle processing in-house, the elimination of coinsurance as a delivery vehicle and, at this time at least, the lack of a replacement system, such as delegated full insurance processing, as HUD proposed in January of this year.

HUD's staffing and travel and expense dollars to support it is inadequate for the task at hand. There's a widespread lack of technical expertise to process, administer and monitor these programs. The problems can't be corrected overnight, but unless we start now with a commitment to improved efficiency and timeliness and a recognition that the problems cannot be resolved without money, the situation will only worsen.

Without FHA mortgage insurance, any reasonable level of affordable rental housing and health care facility production will not occur. With the condition of the thrift industry, the impact of FIRREA on real estate lending in general and the recent actions of Freddie Mac, the continued viability of mortgage insurance, FHA mortgage insurance, as a credit enhancement instrument is absolutely essential, in my opinion.

And I commend the committee for holding these hearings and getting into the issues of staffing and the support facilities, and I would be prepared to answer any questions you may wish to ask.

Thank you.

[The complete prepared statement of George O. Hipps, Jr., follows:]

STATEMENT OF
GEORGE O. HIPPS, JR.

before the

HUD
INVESTIGATION SUBCOMMITTEE
OF THE
SENATE COMMITTEE ON BANKING, HOUSING
AND URBAN AFFAIRS

Hearing on

HUD STAFFING

April 20, 1990

Thank you Mr. Chairman, members of the Subcommittee. My name is George O. Hipps, Jr. and I am a mortgage banker active in the use of FHA and FNMA programs involving multifamily rental properties and healthcare facilities. I am also a member of the Mortgage Bankers Association of America, having served as Chairman of its Insured Project Committee. I am appearing here today as a former HUD/FHA official, having served in various capacities over twenty-five (25) years with the Agency.

I have been asked to give my perspective on issues relating to HUD/FHA staffing, past and present, as well as to issues dealing with monitoring and data availability.

It has been suggested many times that HUD, and particularly the Federal Housing Administration, has suffered from a "brain drain". Clearly, that assessment is accurate. As has been the case with a cross-section of the Federal establishment, HUD/FHA has lost a high number of experienced, talented staff through retirement and resignation. There have likely been a number of factors causing such a drain. An aging work-force caused increasing numbers of retirements in the mid-sixties and seventies. At the same time, changing philosophies of respective administrations, from the production years of the 60's to the moratorium on subsidized housing production during the Nixon-era, from the production mode of the Carter era to the massive budget cuts and drastic policy reversals of the Reagan years, have taken their toll on the ability to hire and retain promising young persons, or to provide adequate career ladder training for those who are employed.

Notwithstanding the so-called "brain drain", this alone did not cause the current lack of capacity to perform in a timely, efficient manner. There were a variety of factors that, taken together with a loss of experienced personnel, brought things to where we are today. At some point, the importance of the Federal Housing Administration and its programs got lost or diminished in other missions and priorities of HUD. The debates over the role of FHA; the production to no-production philosophies from the 1960's through today; all have taken their toll.

I believe that if you look back at HUD/FHA historical staffing figures you would find a significant staff increment during the late 1970's. While much of this was related to the Section 8 program, one must remember that significant amount of new rental housing units were processed and approved during those years.

The message of the incoming administration in 1981 could not have been more clear, however. The philosophy was to significantly reduce the size of the federal bureaucracy and, with respect to HUD/FHA, that philosophy was effected without regard to the ultimate impact on the ability to effectively carry out the mission of the FHA. Staff reductions and/or manpower freezes were prevalent, and quite often without due regard to maintaining minimal capabilities to handle business. Against this background, HUD officials explored a variety of avenues to transfer former in-house work to private contractors. The much talked about co-insurance effort was one of the results of that effort.

FHA has evolved, particularly during the '80's, from an Agency that had pride in, and stressed the importance of timeliness in handling mortgage insurance applications, to one that is currently unable to handle any significant volume of activity in anything close to an acceptable time frame. In fact, I believe HUD, particularly the Office of Housing, has ceased tracking and reporting processing times as a management tool.

During my latter years at HUD, there were three or four areas that were a consistent source of problems in administering the programs within my area of responsibility.

First, and foremost, was the inadequacy of the staff, both in terms of total manpower and in expertise. Particularly with respect to Field office operations, inability to process applications in a timely manner was an embarrassment.

HUD/FHA forgot, or completely disregarded the adage "time is money". Nothing is more critical to the cost of producing housing than being able to secure financing commitments in a timely manner. However, instances of HUD field offices accepting fees and applications for multifamily projects, and then taking 18 to 24 months to process them were not uncommon. In fact, some offices would make every effort to discourage applicants from filing an application. Think of the construction cost savings, including the cost of labor, that is associated with being able to start construction in four (4) to six (6) months rather than in twelve (12) to twenty-four (24) months.

A second major problem, which plagued every new Assistant Secretary, was, and I believe still is, the woeful state of HUD's data system. Millions of dollars have been spent over the years on HUD computer systems. Thousands of man hours have been dedicated to developing data reports that would assist program managers in administering and monitoring their programs. Yet, during my tenure I believe HUD had the worst management reporting system, and the most unreliable, of any organization of its size in this country. The problem was not, and I doubt is today, that HUD did not have the data it needed. To the contrary, HUD collects a wealth of data on the transactions it engages in. However, it has had a continuing inability to retrieve that data from within the system and provide it to managers in a useful form.

A third problem was organizational. The department is structured in such a manner that the Assistant Secretary for Housing - Federal Housing Commissioner, at times has little or no control over the delivery of his/her programs. Field personnel which traditionally handle FHA mortgage insurance are also responsible for public housing and other departmental programs. They report to a manager, who in turn reports to a Regional Administrator, who in turn reports to a Deputy Under Secretary for Field Coordination. While the program Assistant Secretary theoretically is responsible for the technical and programmatic direction of field personnel delivering his or her programs, in reality this has sometimes been honored more in the breach than in fact. Regional Administrators, who guard their prerogatives closely, have often had debilitating turf battles with Assistant Secretaries.

A further problem, and one that is clearly extant today, is the travel and expense money necessary to support headquarters and field activity. Too often one hears from HUD field staff that they cannot perform an appraisal or do a field market review because they lack adequate travel and expense money.

Let me sum up by restating my opinion that HUD does not currently have the staff capacity to routinely handle a normal multifamily workload in a timely and efficient manner. The problem is not solely one of numbers of staff, it is also a matter of the right kind of staff. They need experienced appraisers, architects, cost and credit analysts and, very importantly, underwriters.

Further, HUD must have the money necessary to support the work that must be done. Travel funds available for field personnel are plainly inadequate as are funds for hiring contract manpower. Unless there is a commitment by HUD and by the Congress to objectively examine the real staffing needs of HUD's housing offices, and to provide reasonable support dollars to permit such staff to carry out its functions in a responsive manner, HUD will not be able to replace co-insurance with any form of process that will serve the industry's and the public's needs. HUD must affirmatively recognize the importance of mortgage insurance as a financing tool and re-establish the timely processing of applications as a departmental priority. There needs to be a coordinated agreement between the Executive Branch and the Congress, particularly among those committees having oversight and appropriation responsibilities, to address the problem. The ultimate solution cannot occur overnight, the process of hiring and training personnel is a long one. In the meantime, HUD must begin to examine its processes and to focus on whether the system in use is reflective of the needs of today. In the meantime, HUD must rely on some form of delegated processing for multifamily and healthcare program delivery. At the moment, there is no viable system for mortgage insurance processing in place. HUD and the Congress must recognize the importance of correcting that problem quickly. Without that recognition, given the current state of the thrift industry and the scarcity of other sources of lending, we will not be able to provide needed housing and healthcare facilities, especially for low to moderate income people.

Thank you, I will be pleased to address any questions you may have.

Senator **Graham**. Thank you, Mr. Hipps.

Mr. Kliman.

STATEMENT OF ALFRED KLIMAN, DIRECTOR, OFFICE OF BUDGET, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. **Kliman**. Mr. Chairman, thank you very much. I have a short statement simply identifying myself that I would like to put into the record. I am ready to answer your questions.

Senator **Graham**. Mr. Sevier.

STATEMENT OF WALTER SEVIER, DEPUTY REGIONAL ADMINISTRATOR, FORT WORTH REGIONAL OFFICE, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, FORT WORTH, TX

Mr. **Sevier**. Mr. Chairman, I do not have a prepared statement other than, as Mr. Kliman says, to introduce myself. I'm currently the Deputy Regional Administrator for HUD in region VI, have been since 1973. Prior to that, I was with the FHA in Washington and also have had experience with the Office of Personnel Management and Department of Defense.

Thank you.

Senator **Graham**. Thank you, Mr. Sevier.

As indicated in my opening statement, an issue that has recurred in our previous hearings has been the connection between the quantity and quality of staff available to the Department and its ability to carry out its mission.

At the hearing that we held earlier this week, we asked the question: "Were the programs that the Department was asked to administer excessively complex in the context of the level of staffing available for the administration of those programs?"

I'd be interested in your thoughts and maybe some examples of your experience with the relationship between the level of effectiveness of management of programs and the type, training, and ability to retain a level of management skills.

Mr. Hipps.

Mr. **Hipps**. I think that I would not suggest that the programs, at least the mortgage insurance programs that the Office of Housing has been charged with administering, were overly complex and impossible to administer with the appropriate staff.

But I think that if you go back a number of years to when FHA was an independent agency and then became a part of the Department, there was a methodology in place then that provided for a much, much more detailed level of technical supervision and oversight of its field offices.

There was a larger technical staff in Washington headquarters. Their ongoing contacts with their field counterparts was routine and frequent. And there was an interchange back and forth that took place. There were audits of field offices that were undertaken with in depth audits of their technical processing.

As the Department changed some of its focus and priorities, as personnel changed and as personnel levels decreased, there were things that occurred in the Department that diminished the ability and, finally, virtually eliminated the ability of the Office of Housing to continue to perform those kinds of exercises.

And they lost in headquarters as well as in the field significant numbers of appraisers, appraisers with multifamily experience. They virtually lost at one time, and I can't speak to the condition today, but they virtually lost any kind of a significant cadre of experienced cost analysts that could analyze and come up with the required commissioner's estimate of replacement costs in multifamily transactions.

So what we have today is a much leaner, smaller, technical staff in Washington and a very, very thin technical staff throughout the country and, in fact, in some offices over the past 2 or 3 years, there have been instances where a local office had absolutely no experienced multifamily appraiser on its staff.

And that I think has been a significant contributing cause to some of the problems that we've had.

Senator GRAHAM. Mr. Kliman, within your responsibilities in the Office of the Budget, how would you assess, particularly over a period of time, the changes in the staffing capabilities and the effect of that on your ability to carry out your responsibilities?

Mr. KLIMAN. There is no question, Mr. Chairman, that, over time, the staffing levels of the Department have decreased. This has been true both in headquarters and in the field. And to a large extent, I believe the reductions have been somewhat more in proportion in headquarters than in the field.

Senator GRAHAM. They say the staffing reductions proportionately have been heavier at the central office than in the field?

Mr. KLIMAN. Somewhat more. That's correct.

In addition, as my friend, Mr. Hipps, recites on the appraisers, there have been changes. There was a situation a number of years ago when, in part because of staffing ceilings, a decision was made to go to fee appraisers rather than in-house appraisers. This accounts in a large part for the reduction in staff.

Now, in recent years, there have been attempts to rebuild the in-house appraisal capacity and training programs have been established to train in-house appraisers and cost estimators, recognizing the need that Mr. Hipps has recited.

What I am told though is that, as soon as we get these people trained to the point where they are working well, they're hired away. And I am receiving reports more and more of trained housing people being hired away for higher salaries.

This is something that I have seen over the years, and I think it is more now than I have seen in a long time.

The competitive position of the Federal Government in hiring people who can get a lot more money in the private sector, I think, has affected our capacity, and will probably continue to affect our capacity until there is some basic change in the federal salary structure.

Senator GRAHAM. Do you think the situation at HUD is more or less the same as in other Executive Cabinet agencies, or are there some peculiar factors that make it more severe?

Mr. KLIMAN. I really can't speak to the technical requirements in other Cabinet agencies. But, in HUD anyway, we do have people trained in the real estate industry where they can go to work outside in that real estate industry.

I'm not sure, for example, that a person trained in certain types of research at the Department of Agriculture might be as equally tempted to go to private industry as one of our people dealing with a rather lucrative operation on the outside.

Senator **Graham**. Mr. Sevier.

Mr. **Sevier**. Mr. Chairman, I generally agree with both Mr. Hipps and Mr. Kliman.

Senator **Graham**. I wonder if you could comment specifically about the impact of this at the regional level.

Mr. **Sevier**. Yes, sir.

We have experienced an erosion of our technical or our professional talent and the capacity to process. This has not occurred recently or overnight. It started, in my opinion, about 1970, when we had the basic organization structure established at that time and has been modified some since.

But, beginning in seventy, there was what I would term a deemphasis on the part of the Department on technical or professional training. As an example, for years, the FHA had a technical training program. We brought in probably nationwide well over a hundred young people a year and trained them for a year. And then 2 or 3 years of on-the-job training.

For about 15 or 16 years, that program was dormant. It has started back, as Mr. Kliman indicated—at least in region VI—in about 1986. But we simply went for a number of years without bringing on board young people to train them. And also our own technical training was limited for the staff we had on board. People left us.

And, consequently, we are thin in region VI on technical people, especially in the area of multifamily underwriting.

To add to that problem, we basically have gone into fees and direct endorsement as far as underwriting single family. We did that with our own staff. As you probably know, that's now done by the private sector for single family, and we also went to coinsurance on multifamily underwriting.

I think our people were not adequately trained in how to make this transition, how to adequately monitor these programs.

One final comment. One of HUD's organizations——

Senator **Graham**. Excuse me. When you say "monitor", do you mean monitor the private sector entities that were now performing functions that previously had been done in-house?

Mr. **Sevier**. That's correct, yes.

And then one other comment concerning technical expertise in the field. In one of HUD's reorganizations in 1978, prior to 1978, the regional offices, the 10 regional offices, had the responsibility for providing daily training, on site assistance, monitoring in technical areas to all of the field offices.

In 1978, this function was removed from the regions, placed in Washington, which, you know, distance, staffing limitations made it very difficult to provide the field offices with the day to day technical guidance and training.

So I think that we have lost in region VI over the last 15 or 20 years a lot of our highly trained professional people.

We have not brought in sufficient young people to train. We have had some major program shifts, such as coinsurance and direct endorsement, where perhaps we have not adequately adjusted to the demands of these programs.

So I think, in summary, that we are in the process now of bringing people in and improving our technical and underwriting talent, but it is a problem.

Senator **Graham**. Senator Mack.

Senator **Mack**. Thank you, Senator Graham. Let me maybe just pick up from that point and I guess raise the question I think is important at this point.

Do the three of you get a sense that there is a recognition within HUD today of the shortfall in properly trained professional individuals that are capable of not only monitoring programs but, in essence, monitoring what is happening in the private sector as well?

Is there a recognition of this problem? And do you believe that there are actions that are being taken to begin to solve the problem?

Whoever.

Mr. **Kliman**. I can speak to that somewhat. Just looking at your chart over there, you will see the upward slope in most recent years shows that staffing has been on the increase again. Plus, as I indicated earlier, there have been training programs started recognizing the need for trained appraisers and cost estimators in housing programs.

I can also say—although I do not have the figures with me—that the dollars for training have been increased rather substantially in recent years.

This past year, unfortunately, the reductions and sequestrations took a lot of it away. But we have a lot more again in the fiscal 1991 budget that is before the Congress right now.

So, at least the numbers do say that we plan to do more.

Senator **Mack**. Two points about the numbers I guess I would raise. And it's based on Mr. Sevier's comments that really, at least speaking for his region, that he's been experiencing or is recognizing problems really going back as far as 1970. And I think you specifically mentioned 1978 as another period of time.

If we took that number or the dates back on into the early seventies, what would happen to that line we see? Would it have been above 17,000 in, say, 1978 or 1975? Was that line a kind of continually reducing, falling line?

And the other question I would ask with respect to—I mean, one could conclude that, as a result of the rising line after 1986, that the problems are being addressed. But, really, I would think it was more important to find out where the technical capabilities of the people who would be, in essence, responsible for the increase.

In other words, are we getting the right kinds of people into positions?

Maybe while Mr. Kliman's looking those numbers up, you may have a reaction to that.

Mr. **Kliman**. The highest number that we ever got to in terms of personnel on board was in 1979, when we reached 16,067. Going back to 1970, the number then was 14,661.

So, probably, if you took it way back, the line would be approximately stable, a little bit up and a little bit down.

Senator **Mack**. And I guess we don't want to get really into too many numbers here. But I guess the other thing that was important is the amount of activity that's going on at any given time. For example, 1970, depending on the number of projects, the number of units that are under construction, certainly there's some relationship between the number of personnel and the activity, if you will.

And there's really no way for me to look at that and judge.

Mr. **Kliman**. The types of activity have changed drastically over time. Back before 1974, for example, we had a lot of individual community development type programs—urban renewal, water and sewer, open space—each monitored separately and each approved separately by the regions and headquarters.

In 1974, we changed that over to the Community Development Block Grant program. A totally different type of program.

There have been other changes, as indicated in the testimony, going from processing cases ourselves to delegated processing and oversight of private industry.

I'm not sure that we could develop comparable workload factors. It's just a massive difference in the type of work that has been done.

Senator **Mack**. This is now my second year out of 8 years in the Congress where I have been involved in the Housing issue. And I must tell you, and at least I have some kind of financial and real estate background to draw on that has been helpful, but I must say to you, as I observed during these past 14–15 months the number of different programs and their level of complication, it has been somewhat staggering to me.

I wonder if, over a period of years, if the programs have actually become larger in number and more complicated in the process in which we go about these. And, therefore, even more demands of even more technical qualified staff?

Mr. **Hipps**. I would say yes, Senator, that, clearly, the programs that were administered by the Federal Housing Administration in 1965 weren't nearly as complicated to administer as the ones that the FHA component of the Department had to administer in 1975, and into the eighties.

Section 8 is a much more complex program than anything that was administered in the 1960's. So, yes, there has been a significant change in the complication of the programs. But I would still believe, myself, that the programs are not so complicated that they can't be properly administered if you have the right kinds of people with the proper training.

I do believe that there's a recognition of that in the Department. I am not sure from my perspective sitting outside and working with the Department that there is a priority, however, at this time to mortgage insurance, that there has been a recognition within the Department that mortgage insurance is as important as we who are using the programs feel it is.

And I think that that recognition has to come and a priority has to be made if this problem is to be really significantly improved.

Senator **Mack**. Let me just—I don't disagree with you with the point about, while the programs may be complicated, that given the right level of technical expertise within the Department, certainly it should be able to be handled.

But let me just ask this:

Is there any feeling on your part or either of you as to whether there is a role or whether we should look at the possibility that simplification of program design at the same time that we are increasing the capabilities of the technical staff wouldn't be a bad approach?

Mr. **Hipps**. I would certainly agree with that. The Department should be looking at ways to simplify its processes and the design of its programs. Absolutely.

Senator **Mack**. Mr. Sevier, do you agree with him?

Mr. **Sevier**. I would agree with that. And going back for a minute, if I could, Senator Mack, to your question about what's happening now in the field, in region VI? Has there been a recognition that we've had an erosion of some of our better talent?

I think there has been. We have brought on some technical trainees, young college graduates, in the various underwriting disciplines. We will be bringing on more this year. Training is being emphasized more. And a lot of this support is coming out of Washington.

And so we are bringing the people on. Of course, they're not at the level yet where you would expect them to be of great benefit, especially in the more complicated multifamily programs. But, at least there seems to be a recognition of the problem and an effort to do something about it.

Senator **Mack**. I think that one of the things that kind of connects, if you will, the problems that we've seen at HUD and the problems at the S&L industry, as the S&L industry went through some form of deregulation and expansion of the spectrum of activities that they could become involved in, we saw at the same time a reduction in the number of people who were responsible for regulating, investigating, auditing those activities, when the reality is, if you're going to become involved in more complicated transactions, the numbers of people who are going to be investigating that ought to have the skill and you ought to have the numbers, you know, to carry out your responsibility.

And I sense in some ways we've got a similar situation here. I think of myself coming into the financial area of trying to analyze mortgages, values, income and the relationship of those, and then layering on top of that the various kinds of mortgage instruments and other debt instruments.

And even going through the process of training new people, the reality is that those in the private sector are going to be probably many steps ahead of the capability of those who you've just brought in and trained.

So I sense we've got still quite a way to go with respect to training.

Mr. **Hipps**. If I may, Senator, I think there's a component to that, too. If we find ourselves again, if the Department is building up and trying to begin to replace its talent, if they find themselves again in the situation that occurred in the early part of the eighties with repetitive, year after year run-down in staffing levels because of budget restrictions, we will be right back where we are now.

And the Federal Personnel System, as it is, is an enemy to building any kind of young people coming in and staying with the Department and gaining the expertise that is needed in the future.

Senator **Mack**. Let me get you to comment a little bit more on that. You say that the system is an enemy to bringing in new, qualified——

Mr. **Hipps**. If you start reducing your staff, the first people to go are the last people in. And that is not conducive to being able to bring in people out of college or from wherever and training them and keeping them over the long-term if one anticipates that there are going to be cuts in staffing.

Senator **Graham**. I'd like to follow-up on that question. To use an analogy in the criminal justice system, a very controversial prosecutorial strategy is plea bargaining.

My sense is that plea bargaining is not inherently inappropriate. It only becomes so when it is done out of necessity. That is, where the system is so overcongested that you plea bargain because you don't have the realistic prospect of being able to carry the case to trial.

And in the same way, I don't think that the Department using outside contractors to perform various functions is in itself plus or minus. It depends on whether it's the appropriate way to perform the job.

My concern is whether the Department has gotten itself into a position in terms of its inside capability that it is using outside vendors out of necessity rather than out of a reasoned judgment that that's the most appropriate means of accomplishing the task at hand.

As an example, at our hearing 2 days ago, we heard that one of the weaknesses that was recognized in the 1989 FMFIA report, which is the annual report of internal management controls, was the section 8 program.

The response to that identified weakness has been to bring in an outside CPA firm to develop the Department's response to the identified weaknesses in section 8.

My question was:

Was that use of an outside firm the most appropriate managerial response to that issue? Or was it an example of a response that was mandated because of a sense of the lack of internal capacity to do that analysis?

After that long introduction, the question is:

Your comment on the use of outside contractors and what that reflects about the staff capability, real or perceived, by the top levels of the Department.

Mr. **Hipps**. I'll start off by saying I don't think there's any doubt that, in the 1980's, the use of, the increased use of outside contractors was a direct response to the necessity of finding ways to continue to deliver the program, the housing programs, in the face of significant budget cuts and the approach of that particular administration to the Federal Government as a whole.

I don't—there was also, I think, a judgment that there are some functions, and there are today some functions in HUD that probably can be as well or better performed outside the Department. And I think that's quite appropriate.

So I think there's a mixture of both, Senator.

Senator **Graham**. Are there any areas where the Department went outside in order to get a function performed which, in your judgment, would have been, from a managerial standpoint, preferably performed inside if there had been the capability to do so?

Mr. **Hipps**. Well, if the capability had been there to perform and deliver in a timely manner, I think that, from a managerial standpoint and from the Department's policy standpoint, they would have been better off to have kept their mortgage insurance processing inside rather than delegating it outside.

The fact of the matter is that we did not have the capacity, and it was broadly recognized. And the alternative was to continue to not be able to deliver programs.

Senator **Graham**. To inject an editorial observation, that judgment is going to end up costing the American taxpayers somewhere in the range of $1-3 billion based on the losses that are currently known within the coinsurance program.

Mr. **Hipps**. That's, in my opinion, Senator, a complex—it's not easy even to answer because my own personal opinion is that what is going to cost the Government, whatever that final loss figure may be is more directly related to the lack of proper management and monitoring of the program in its early years, and the unwillingness on the part of people charged with those responsibilities to act promptly in the face of known abuses.

So it's hard for me to say that the decision to go outside with coinsurance was the cause of the problem. My opinion is it's more the way it was managed and the lack of taking action when action was probably called for.

Senator **Graham**. To continue with that focus on coinsurance program, when the Department began to shift in that program from being the direct operator of a mortgage insurance program to both an operator and overseer of third parties carrying out a delegated Department set of responsibilities, was there a commensurate shift in the training or type of people who were brought in for that program?

The skills that may be appropriate if you're actually running something aren't necessarily the same skills as monitoring a third party carrying out that function.

Was there a recognition of that difference within the Department when there was the change in decision as to how to run that program?

Mr. **Sevier**. Mr. Chairman, in the field, basically, our staff of course remains the same as far as their background and technical expertise, which was in this relative to coinsurance was multifamily underwriting, which was an appropriate background for these people to monitor coinsuring lenders.

However, basically, I would have to refer to Mr. Kliman and Mr. Hipps, the actual monitoring of coinsuring lenders was basically a Washington function. And from the perspective in region VI, coinsurance seemed to lack adequate monitoring. There seemed to be a perception—well, when a Federal agency I think has a new program, there's a sincere desire for this program to succeed, to get people to participate and to have the program a success.

And I think, as a result of the desire to see mortgagees become coinsuring lenders and for coinsurance to be a viable vehicle for Federal insurance, I think that there was a lack of monitoring, a lack of perhaps aggressive monitoring that was needed in the beginning.

So I think we had the people at the time, but I just think that there was a lack of aggressive monitoring, for the reasons I mentioned.

Mr. HIPPS. With coinsurance, Senator, there was another piece that I guess would happen any time you take a large function and privatize it, that when the coinsurance system was announced and put in place, the lenders that participate in these programs had to begin to staff up with the kinds of expertise that they needed in order to carry out the functions.

And one of the places that they quite often looked at were people within HUD. And they ended up hiring away from HUD people, typically, people who were senior underwriters with a lot of years of experience. And that, too, helped take out of the system, out of the Department, people who were important to its operation.

Senator GRAHAM. My time for this round is over, but I would just summarize with a feeling that when the Government decides to make a major change in the management of a program, it needs to look at all of the implications of that change and assure itself that it has made the proper, both administrative and, in some cases, almost cultural shift required to assume a different perspective in terms of Government responsibility.

And I gather that that was not attended to adequately as it relates to the coinsurance program.

Yes, Connie.

Senator MACK. Maybe we ought to just continue to follow up on the coinsurance thing from the standpoint of how it relates to personnel.

Was coinsurance a result of that declining line in personnel? And I'm going to assume as well the technical capabilities? Or was coinsurance a program that allowed the Department to continue the reduction of that line?

And maybe I might even just add in:

Is that even a relevant question?

Mr. HIPPS. Well, I think the answer is that coinsurance certainly wasn't a creature of decision to have significant budget reductions. It was already on the books. But, in the face of an understanding that the administration in 1981 wanted to reduce the Federal budget and a recognition within the Department that there had to be a way of continuing to deliver the programs, that coinsurance was a natural direction for them to turn. There had already been a lot of work done on coinsurance with State agencies developing regulations for that purpose. And I think it was just the natural—it was there. It was in place in terms of the statutory authority and they were under a tremendous amount of pressure from the industry to be more responsive in processing mortgage insurance applications.

Senator **Mack**. So, in essence, it's kind of a combination of both of the points raised.

Mr. **Hipps**. Right.

Senator **Mack**. The desire to continue to deliver program drove them to use a coinsurance program which was really already on the books, expand it so that they could continue or increase the delivery of the product.

Let me raise with Mr. Kliman again, going back to that line.

Would you say that the reduction—is there any portion of that reduction that is as a result of the termination of programs or changes in programs, and if so, what portion would that be?

And does that question have relevance with respect not only to the numbers but also with the technical capability as well?

Mr. **Kliman**. I'm not sure I can address technical capability, but let me address the first part of your question anyway.

There is no doubt that a substantial part of the decrease is because, one, we went to contract appraisers instead of in-house appraisers. That was in the—I don't remember the number—but it was in the hundreds of staff years.

And another substantial part of the downward slope was due to the determination to go out for direct endorsement on single family programs rather than process in-house.

I would say, between the two of those, you probably have the primary cause of the numerical reduction in that time. In addition, a decision made nearly 10 years ago to move the subsidized housing program from new construction to income assistance also resulted in a substantial workload reduction allowing further staff decrease. There are other ups and downs, but I think those were the two largest causes of the decrease.

Senator **Mack**. I would draw from that comment then that the number of employees maybe is not the important thing to look at. It really is what I think you all have touched on. And that is that the commitment to training, the commitment to raising the technical level of capability as opposed to just looking at those numbers.

Mr. **Kliman**. I would concur with that observation, Senator.

Senator **Mack**. Mr. Sevier, maybe you could tell me a little bit more from your perspective anyway what caused the reduction—and I think you indicated this—that, since roughly 1970 there had been a decline.

And I think you were speaking probably just for your region, but maybe it was countrywide, that there was a decline in the technical capabilities.

Could you elaborate a little bit more on what brought that about?

Mr. **Sevier**. Yes, sir. As I mentioned, it started occurring about 1970, when we organized into our basic structure and FHA became a part of HUD.

At that time, there was a lack of emphasis, almost a deemphasis on technical or underwriting expertise.

Senator **Mack**. But, why was that?

Mr. **Sevier**. Well, I really don't know other than some statements that were made at the time that the FHA seemed to be an overly technical agency. I really don't understand that being a criticism. But, for whatever reason the decisions were made, its central office, to discontinue the technical training programs where we brought in, again, young high school—not high school, but typically young college graduates, trained them for at least 12 months. And then they received a couple of years of on-the-job training following that.

This program was dormant in region VI and, to my knowledge, in the rest of the country probably from about 1970 to 1986–1987.

During that period, of course, we lost people—attrition. People retired, took other jobs. So we suffered a loss of some of our more experienced people and were not bringing people on board and training them to fill these gaps.

In my opinion, you're looking at probably 5 to 10 years for a technical trainee to be a fully qualified multifamily underwriter or appraiser, or in one of the underwriting disciplines.

Coupled with this, as I mentioned, we had some other changes. In 1978, the day to day technical advice and assistance and guidance that had been furnished by the regional offices was moved to Washington, which made it more difficult and costly to provide this type service to the field offices.

So I think the field offices suffered during this time from that lack of training.

And then, if you add to that during the same 15–20-year period, the fact that beginning in 1980 and continuing through 1984, the Department basically turned over the single family and multifamily underwriting to the private sector, historically had been performed by FHA, this obviously was a new way of doing business, with new requirements on the Department, rather than performing these functions, basically, they would be turned over or contracted to the private sector.

We, of course, retained the monitoring responsibility, which in region VI I think proved to be inadequate, and possibly in other regions as well.

The monitoring I think again was—or the lack of monitoring—was a result of several things. In some instances, I think we probably had insufficient experienced people to do the monitoring. I think again there was an attitude on the part of the Department that, if you're going to have the private sector participate in these programs, you know, you can't beat them down in the beginning.

You need to let them function to carry out the programs. And I think there was a reluctance to do a lot of hard-nosed monitoring that should have been done, should have set the tone in the beginning but, unfortunately, did not.

So, really, I think that summarizing, if it can be summarized, that 15 or 20-year period, I think that's what happened to HUD in the field.

And perhaps one final comment on the turning over our underwriting to the private sector. There may have been in region VI and other regions as well a failure to adequately recognize the different interests. I mean, the private sector interests are different from ours. They should be. I'm not criticizing that.

But I think, as a result of their interests being different, it would require a strong monitoring program, which I think, unfortunately, we did not have most of that time.

Senator **Mack**. OK. Let me just summarize at least what I hear you saying.

Really, over a 15–20 year period there has been a gradual reduction in the technical capability of HUD?

Mr. **Sevier**. Yes, sir.

Senator **Mack**. Do you agree with that, Mr. Hipps?

Mr. **Hipps**. Yes, I do. Yes.

Senator **Graham**. I'd like to just continue for a moment the discussion of monitoring specifically.

During the period that the reductions in quantitative staff were going on in the Department, there's some evidence that the monitoring function was particularly affected in terms of reduction of numbers.

Is that a fair characterization either in your region or at the central office level?

Mr. **Sevier**. Mr. Chairman, I think it's a fair representation but in region VI, I really don't think our problems were or are now directly related to inadequate numbers of people. I think they're more directly related to the quality of the people, the need for highly trained people.

So I think it's more of an approach to the problem, a recognition of the differences between the private sector and HUD, better trained people, bringing people on board and putting them in these technical trainee positions.

I don't know if I'm adequately explaining it, but it just seems to me it's a hard-nosed approach to monitoring, better training for our staff and developing a better quality employee relative to multifamily underwriting capability.

Senator **Graham**. Mr. Kliman?

Mr. **Kliman**. I don't have any direct knowledge of whether or not the monitoring in the field was affected or not. I tend to agree with Mr. Sevier that the issue is one more of quality than of overall numbers. Perhaps in individual situations, of course priorities of the regional administrators or field office directors resulted in monitoring changes.

Senator **Graham**. In October of last year, the General Accounting Office testified for the House Subcommittee on Civil Service that HUD had an oversupply of schedule C political appointees.

The GAO also concluded that it was unhealthy for an agency to have such a large number.

The Volcker Commission reached the same conclusion, stating, quote:

> There is growing evidence that excessive numbers of Presidential appointees may actually undermine effective Presidential control of the executive branch.

Could you comment about as to whether you believe there has been a proliferation of political appointees within the Department and what the impact of that has been on the management of the agency?

Mr. **Kliman**. Mr. Chairman, this issue is also one that came up last year during our appropriations process, where the Appropriations Committees first wanted to put a cap on the number of political deputies and then changed it to a cap on the number of political SES persons.

What it ended up with was a request to the Office of Personnel Management to do a study to send to the Appropriations committee a report on whether or not the Department of Housing and Urban Development had a correct or an incorrect proportion of political appointees in the Senior Executive Service.

The OPM finally reported that the numbers were not out of line.

Senator **Graham**. Would anyone else care to comment on that?

Mr. **Hipps**. I think, Mr. Chairman, that same comment that you related to was also made in the findings of the Grace Commission with respect to the Department, if I remember correctly. And I think you have to probably separate it a little bit.

There are a variety of different types of political employees, and I think you have to separate those who are managerial with line manager responsibility from those who are schedule C special assistants when you're making any kind of analysis.

I can't say that there are too few or too many in the Department. I don't have any basis for making that judgment.

Senator **Graham**. How does the number of political appointees affect morale and the ability to attract and retain quality career service people in the context of what their opportunities may be?

I might say I recently met with a gentleman of a firm which has a substantial family ownership. And he said his policy was that they would only have two people with any one generation of the family in the firm because if they had too many family members, it would make it difficult for them to attract the kind of professional/managerial talent that they needed to be successful.

Is there some relationship within an agency like HUD to the ability to attract career people in terms of the prospects of their emergence within the Department relative to political appointees?

Mr. **Hipps**. I don't believe that it affects career people in that respect to any significant degree. I think, as far as relationship is concerned, really doesn't have anything to do with the number of political employees. It has to do with the people themselves and their professional competency.

And if you put people in there in political positions that have no experience, no knowledge, and you put them in a position where they're going to be giving orders to or supervising people with 15 or 20 years experience, you will have a problem.

But it's really a personal relationship more than anything else.

Mr. **Sevier**. Mr. Chairman, that has not been a problem in region VI. In the field of course we only have one political appointee in a line management position, you know, in the entire region.

And so, as far as recruiting or retaining people or their morale in the field, again, the political appointee question really would not impact the work force to any degree.

Senator **Graham**. At the meeting of this subcommittee 2 days ago, we heard a career employee testify that she expressed concerns about the quality of information to be included in the 1987 FMFIA report to the President.

Those concerns were ignored by her superiors. Similarly, Mr. Sevier, I think you have testified that you made an attempt to warn central office about some of the problems related to the Colonial House apartment project, and that those warnings were not heeded.

What do those examples say about the management reporting system and the relationship between career professionals and political appointed decision-makers?

Mr. **Sevier**. Well, I really don't think it is any indictment of the political appointees. I did back beginning in 1984 point out the problems to Washington about the coinsurance program, at least the way it was being administered in region VI.

These were listened to. Unfortunately, in my opinion, at the time, appropriate actions were not taken by the Department.

I really, going back to Mr. Hipps' comments, I really think it's more the qualifications of the individual rather than the type appointment. I cannot, in my own mind, relate the considerable problems we're encountering with the coinsurance program in region VI with political appointees.

I think there were mistakes made by the Department. I think there were wrong decisions made—lack of monitoring. I could talk on these things for a couple of hours.

But, specifically, to say coinsurance problems are related to political appointees within HUD at the time, I never made that connection.

Senator **Graham**. Connie.

Senator **Mack**. I really just have only one further question, and it's kind of an open-ended one.

As a result of our discussion here this morning, is there an additional comment that any of the three of you would want to make with respect to the issues that we've been talking about?

Mr. **Sevier**. There's one thing I forgot to mention a few minutes ago. On staffing, I think that, you know, our numbers are adequate and that, you know, that's not the problem. We could use more staff immediately, like this year, to bring on board trainees that are not productive. And we would need to carry these trainees for at least a year, recognizing that they're going to actually eat up our resources and not, you know, be productive at all.

So, while we in the long-term I don't think need any additional staff, at least based on workload at this time, we do need to bring on, in my opinion, more technical trainees in the field.

Mr. **Kliman**. I would just add one thing to what Mr. Sevier said. We had expected, based upon the initial results of our appropriation process, that we were going to have the ability, the additional staff years, to do just what he wanted to do.

That ability was taken away from us through two different events—one, an across the board reduction in order to fund drug programs and, second, the Gramm-Rudman sequestrations.

We are now at the point where we're doing well just to keep the existing staff going. And we are without the ability to do what Mr. Sevier wanted to do, which we thought we were going to be able to do—that is bring on the trainees this fiscal year.

All I can say, and this is a personal observation, I just wish that we could be exempted.

Senator **Mack**. I understand.

Mr. **Hipps**. I would like to make one point, Senator, that we really haven't touched on very much. And that is that all of the quality staff in the world that we can put out into the field offices won't be able to do the job if there isn't some way found to assure that they have the kinds of travel and expense dollars necessary to support their field work.

And when I go into a HUD field office in mid-February and learn that their appraisal staff has $300 of travel money left for the balance of that quarter and that that's not enough to get an appraiser across the State to do an appraisal on a nursing home that may have an expiring certificate of need, there has to be something wrong with the system that allows that to occur.

Senator MACK. OK. Thank you.

Senator GRAHAM. Thank you, Connie.

And my concluding question is also the same open-ended. You have talked about some of the staffing issues, the brain drain of people leaving the Department to go to other related activities. Our information is that, within the next 3 years, about one of six HUD employees will reach the eligibility age for retirement. So there's going to potentially be another serious challenge to maintaining the professionalism of staff.

Do you have any recommendation as to how we can reverse that brain drain and, specifically, how serious do you think the issue in the next 5 years will be with the potential of large numbers of retirement of experienced personnel?

Mr. SEVIER. Mr. Chairman, in region VI, without a very active program of bringing people in, highly qualified people, and training them, I think it could very well be very serious, a disaster for the region within 3 to 5 years if we don't have the capacity, again, to bring on board people and train them.

So it would be very serious.

Mr. KLIMAN. All I can say in response to that, Mr. Chairman, is that you are looking at a person who will not be reaching the eligibility for retirement, but has reached it and passed it. And looking at how much I am currently earning per hour, I wonder why I'm still here.

I would hope that there could be some change in Federal pay standards—not just for SES, but for employees throughout the Department and the Government. Because unless the pay system is reformed, there will always be a brain drain.

Senator MACK. What is SES? I'm sorry.

Mr. KLIMAN. Senior Executive Service.

Mr. HIPPS. Mr. Chairman, I would underline what both of the gentlemen to my right have said and point out that Mr. Sevier is also in that capacity of being able to retire any time he chooses. And I think there are two examples to my right of what the brain drain—you've got 65 years of Federal service here at this table to my right that will be probably leaving the Department in the near future.

And unless there is a very, very significant effort to train not only in region VI but throughout the entire system, including headquarters, this situation is bound to worsen.

I think that that's not going to be an easy job or a quick job, and that the Department almost has no choice but to move forward with supporting the activities of the private sector in assisting with processing in these programs until such time as they can get their own in-house staff to the point where they can do it without that kind of assistance.

Senator **Graham**. Thank you very much. This is a very illuminating panel. Thank you.

Several Voices. Thank you.

Panel No. 2.

[Pause.]

Senator **Graham**. I will introduce the members of panel No. 2 in the order that they appear on the agenda, and will then call by name.

First is Mr. Marvin Siflinger, executive director of the Massachusetts State Housing Finance Agency. He is representing the National Council of State Housing Finance Agencies.

Mr. Daniel Grady, president of Monfric Corp., of San Diego, CA, who is representing the National Assisted Housing Management Association.

Mr. John Koelemij, president of Orange State Construction Co. of Tallahassee, FL, representing the National Association of Home Builders.

And, Mr. Brian Chappelle, staff vice president for Residential Finance/Government Agency Relations, the Mortgage Bankers Association, Washington, DC.

Gentlemen, I appreciate very much your being here today and sharing your perspective on these issues.

Mr. Siflinger, did I pronounce that correctly?

Mr. **Siflinger**. Yes, you did. Thank you.

STATEMENT OF MARVIN SIFLINGER, EXECUTIVE DIRECTOR, MASSACHUSETTS STATE HOUSING FINANCE AGENCY, BOSTON, MA, FOR THE NATIONAL COUNCIL OF STATE HOUSING FINANCE AGENCIES

Mr. **Siflinger**. I just might share with you some of my background that may be helpful. As the other panelists, I am a former HUD careerist, a member of the Senior Executive Service, and spent 25 years with the Federal Government, most of those years with HUD.

From 1976 to 1983, I was the Director of the HUD office in Boston, with responsibility for five of the six New England States.

So I would be in that capacity, in addition to my role here today as a member of the National Council of State Housing Agencies and Director of the Massachusetts Housing Finance Agency, be delighted to talk to you about my experiences in HUD.

I worked in both the New York and the Boston offices of HUD during almost 25 years. So it's just a way of introduction.

I have some strong views regarding the experiences of HUD since January 1961, when I first started working for the Department. And if I could share some of those views with you now? Or, wait?

Senator **Graham**. Well, I think, if, in your opening statement, you could comment particularly on your view chronologically of the changes that have occurred within the Department, particularly from the perspective of the relationship of staffing and organization to the accomplishment of mission, and the relationship to agencies like yourself, who are in close partnership with the Department.

Mr. **Siflinger**. Well, I think you really hit it on the head with your comment regarding mission.

I came to HUD in 1961 as a young GS-7, attracted to HUD because of its mission in the community development and housing area, and was part of a continuing group of young people, principally interns, who would come to HUD during the 1960's and throughout the 1970's, attracted to the Department because of its statutory mandate.

And I think the strength of HUD through the 1960's and 1970's was its principal resource, being people. The constant infusion of staff, the high attention in the 1960's and 1970's to the training of the generalist and technical staff. And I think it's probably fair to say, and I know this is a generalization, that during the 1960's and 1970's, the workload generally increased, certainly in housing, from the Housing Act of 1968 onward.

We saw a major increase in HUD responsibilities.

I generally agree with the comments made particularly by Mr. Hipps and Mr. Sevier, with perhaps one exception.

In 1970, after being with HUD for 9 years, I was appointed as the chief underwriter of the Boston Office of HUD. And I think we heard from them that over—or particularly from Mr. Sevier that there was perhaps a lessening of attention to the quality in the FHA decisionmaking process.

I don't agree with that. As former chief underwriter, particularly with that appointment in 1970, and that was part of a major HUD reorganization, the role of FHA changed. The attention of quality through the 1970's did not diminish. I was chief underwriter. I was an assistant regional administrator for housing management in New England and Director of the HUD Office until 1983.

And certainly through the 1970's, I was able to send my technical staff to training, to assure that where there were shortfalls in training, that that was buttressed.

I think the confusion perhaps lies in the changing role of FHA. FHA, in the 1960's and through most of its years, did not commit mortgages to the extent that it should have in our inner cities.

And one of the objectives of the 1970 reorganization was to expand the role of FHA to give FHA technicians responsibility in the Public Housing Program. And to bring the housing role more in line with the community development objectives of HUD.

And, in 1970, there was a disagreement on the part of the FHA staff that that role should be changed. So I don't think we ought to confuse quality with a changing role. In my judgment, the change in quality occurred in the 1980's and there's no question about that in my mind. Through the 1980's, the mission of HUD radically changed. Many people left the Department.

And I must say, and I'll end on this note, that I am delighted to see that, with Secretary Kemp and his staff, that there is a recognition of this issue and just that line showing an increase in staff and a recognition that there ought to be an intern program is a very critical and helpful factor.

And I commend the Secretary and his staff for that.

Senator **Graham**. Thank you.

Mr. Grady.

STATEMENT OF DANIEL GRADY, PRESIDENT, THE MONFRIC CORP., SAN DIEGO, CA, FOR THE NATIONAL ASSISTED HOUSING MANAGEMENT ASSOCIATION

Mr. **Grady**. Thank you, Mr. Chairman.

Just by way of introduction, my company has been involved in the development, ownership, and management of multifamily assisted programs since the late 1960's. And during that time, I have operated apartment projects in such diverse locations as Massachusetts, California, Colorado, Arizona, and Texas, so that I am looking——

Senator **Mack**. Well, you missed Florida.

Mr. **Grady**. I missed Florida. I'm sorry.

And I also have served——

Senator **Graham**. It's not too late, Mr. Grady. [Laughter.]

Mr. **Grady**. Senator, I will take your invitation. [Laughter.]

I don't want to compete too much with my friend on my right, who will represent Florida very, very adequately.

I have also served as the President of the National Advisory Council, which merged into what is now ANOMA, and the members of NAAH, the National Association of Assisted Housing, serves, probably manages over 50 percent collectively of the housing inventory.

And it is from that perspective that I would like to talk to you today. And if I may, I have a prepared statement which I would like to have included in the record.

Senator **Graham**. It shall be.

Mr. **Grady**. And I would like to just make highlights.

I generally agree with what has been said. And I think that one of the problems which we have faced is that, at the start of the Reagan administration, it became very clear that that administration not only wanted to shut down the new production programs, but basically would attempt to liquidate some of the housing inventory and to get the Federal Government out of the housing business.

The increasing Federal deficit certainly put pressure on OMB to cut the expenses, and this has been testified before.

And OMB actually became very, very active in setting some of the policies. And because of the matter of management of the previous Secretary, it was perceived that maybe OMB was, in fact, directing the Department.

And the combination of all of those things, together with a delegation to the private sector of some of the functions which had been the responsibility of HUD, certainly sent a very, very clear signal to the most qualified employees that there remained very few prospects for advancement at HUD.

And this reorganization triggered a mass exodus from the Department of very qualified career employees. And, at that time, a number of those responsibilities were transferred to the private sector, who, in many cases, had to staff very quickly and rapidly, and they were able to offer to those employees very attractive incentives to come to the private sector, thereby increasing this exodus.

I believe that, in order to change this completely, it is necessary that a climate be set that will indicate that HUD again wants to go on a mission that was described by Mr. Siflinger of actually providing housing to all of our people, and that there will be some very meaningful work to be done.

It is necessary to attract and rebuild the staff to attract some new, qualified—a new generation of qualified employees who will come to HUD if they can really believe that their work is meaningful, that the morale problem has been changed and that they can be proud of working in that Department.

I think that I would like to commend at this time Secretary Kemp on the choice of some of his top management personnel, particularly in the Office of Housing, where he has chosen from the Assistant Secretary to Deputy Assistant Secretary some experienced professionals who are able to very adequately supervise the excellent career staff that might be remaining.

We certainly experienced a deterioration of the staff. We saw people leaving all the time. And, every month, there seemed to be a new face appearing somewhere.

And the new people coming on, even though they wanted to do a good job, did not have the experience, did not have the background, did not have the history.

I think many of them were also confused by the various different directions that came to them in the 1980's from some of the appointed staff, particularly when those appointed, political appointees, were thwarting the will of Congress and actually trying to find loopholes in order not to implement certain legislation which had been passed by Congress.

That certainly sent a very wrong signal.

There was also a problem of organization within HUD. I think that the responsibilities between the Central Office, the Regional Office and the local offices have been confused since the late 1970's, when this reorganization took place. And it became worse during the 1980's.

The emasculation of the responsibility of the Assistant Secretaries, who were responsible for the program and for the setting of policies, but no longer after this reorganization had the authority to see that the field offices actually implemented their program; because the field offices reported to the regional administrators, who bypassed those Assistant Secretaries and reported to a deputy undersecretary who was not responsible for the program.

It created confusion, and you had the example of various interpretations as you moved from region to region.

We have talked about monitoring. Monitoring did not take place properly. And HUD did not have the capability of doing adequate monitoring. We talked about training. And I certainly agree that there was not sufficient money, travel money, for training.

There was not even sufficient money for people to go and visit projects that might be in trouble. And, sometimes, we saw the example of management reviews which had been scheduled and had to be canceled and postponed until the next quarter, or sometime until the next fiscal year, because there was no travel money for a person to come from the area office to that project.

I think that the evidence is quite clear what went wrong. And now I believe is the time that we should reverse this and by having the administration and the Congress work together and send a clear signal that we expect to solve the housing problems of the Nation and to devote the resources which might be necessary to solve the problems. Then we will be able to rebuild the staff, to change the morale and to move ahead.

And this is my recommendation of what should be done at this time.

[The complete prepared statement of Daniel B. Grady follows:]

TESTIMONY OF

DANIEL B. GRADY, PRESIDENT

MONFRIC, INC.

IMMEDIATE PAST PRESIDENT

THE NATIONAL ADVISORY COUNCIL OF HUD MANAGEMENT AGENTS

BEFORE THE

SENATE INVESTIGATION SUBCOMMITTEE

OF THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

U.S. SENATE

APRIL 20, 1990

Mr. Chairman, members of the Subcommittee, my name is Daniel Grady. I am the President of Monfric, a company which has been involved in the development, ownership and management of assisted housing since the late 1960's. During that time we have operated apartment projects in such diverse locations as Massachusetts, California, Colorado, Arizona and Texas. In addition, I am the Immediate Past President of the National Advisory Council of HUD Managing Agents (NAC). I am now a member of the Board of the newly formed National Assisted Housing Management Association (NAHMA), which was formed this year as a result of a merger of the NAC and the National Federation of Associations of HUD Managing Agents. Collectively, the members of NAHMA manage more than half of the nation's privately owned, federally assisted housing units.

It is on the basis of the knowledge that I have gathered in these roles that I address your subcommittee today.

Mr. Chairman, before addressing, specifically, the questions which have been submitted to me by the staff of your subcommittee, I would like to express my general opinion regarding the manner in which the Department of Housing and Urban Development has operated during the past ten years and give you my views on what actions are needed to correct the problems which you are investigating. I would hope that at the conclusion of these hearings the Congress and the Administration would agree on a program which would require HUD to truly and faithfully fulfill its mission of leading the way towards the goal of a decent home in a suitable environment for every American family.

It is clearly evident that the Reagan Administration decided, shortly after assuming office, that not only did it want to shutdown, as rapidly as feasible, production of privately owned assisted housing and public housing but would also attempt to liquidate the large inventory of such housing which had been built in the previous 15 years. The increasing federal deficits of the early 80's caused the Office of Management and Budget (OMB) to take a hard look at every Federal agency to reduce expenditures. The former HUD Secretary stood by while OMB drastically cut back HUD's resources, became more deeply involved in setting policies and in fact was perceived as running the Department. This was particularly true in Housing where the frequent turnover of Assistant Secretaries and Deputy Assistant Secretaries contributed to the lack of effective leadership. Further exacerbating this situation, some of those appointees wanted to demonstrate that they could effectively carry out OMB's desires by reducing staff and attempting to liquidate the inventory of assisted housing.

The combination of inaction, improper action, and delegation to the private sector of what had been the Department's responsibility, sent a clear signal to all HUD employees that there remained very few prospects for advancement at HUD. This realization triggered a mass exodus of qualified career employees at a time when more of the Department's responsibilities were transferred to the private sector through the implementation of coinsurance and delegated underwriting. Many private firms were able to quickly staff up by offering positions of responsibility and great financial incentives to the best qualified and most experienced HUD civil servants.

I certainly do not want, at this time, to reemphasize nor dwell upon the mismanagement and abuses which have been reported in the past 12 to 15 months. I believe, instead, that it would be most advantageous to this nation's housing policy if we were to examine where we are now and recommend actions to be taken in order to restore HUD to the status it previously enjoyed and, indeed, to restore housing to the high priority that was proclaimed by all Presidents from the mid 60's through 1980.

To achieve this result it is essential that the present Administration and the Secretary of HUD send a clear signal, not only by word but also by deeds, that the current shortage of decent housing for low and moderate income families is unacceptable. The Administration must offer to Congress a program of action backed by sufficient resources to alleviate this shortage. In addition, Congress must be willing and able to appropriate sufficient funds to restore the Department to its former preeminent position so that it can embark upon a course of action which will truly and effectively deal with the problems of the homeless, conserve our present housing inventory, and add to this inventory in those areas of our nation where we truly have a serious housing shortage.

Such a policy should create a climate within HUD which would attract a bright, dedicated new generation of civil servants who will feel that their work in the Department will be meaningful, that they will be properly recognized and rewarded and who will proudly tell their friends, acquaintances and family, that they are working for the Department of Housing and Urban Development and performing functions that are essential to the welfare of our nation. This new climate should be created immediately. Secretary Kemp should be commended for having started on this course by choosing experienced professionals to occupy the leadership positions in housing.

I would now like to address specific questions which were included in the outline prepared by the staff of your subcommittee.

1. CAPACITY AND SKILL LEVELS: In addition to the budget cuts and overall reduction in the federal workforce previously discussed, the factors which contributed to the deterioration of HUD's staff included the obvious desire on the part of some of the political appointees of the Reagan Administration to use every device possible to thwart the will of Congress and take actions which, indeed, would lead to the liquidation of the housing inventory which had been built over the previous 15 or more years. The deterioration of this staff was evident to those of us who had to deal with the agency on a daily basis. Qualified, knowledgeable people were leaving the agency every month. They were replaced by persons who, in many cases, were well intentioned but had no previous experience to assist them in making the correct decisions. Even when they wanted to perform their functions properly, they were often discouraged by instructions which, in many cases, were designed to find loopholes in legislation so that the clear intent of Congress could be avoided. Under those conditions, the quality of work deteriorated rapidly and decisions were postponed. The areas most adversely affected were those requiring long-time experience such as, appraisals, underwriting, and budget analysis.

The responsibilities of Central Regional and Area Offices were never clearly defined since the establishment of Area Offices in the late 70's. However, because of the various reorganizations which took place during the 1980's along with the lack of adequately trained personnel in positions of responsibility, these functions became even more disorganized. Whenever a strong leader was identified, that person took charge and assumed more responsibility and more of the decision making authority than should have occurred. Many of HUD's clients tried to deal directly with such persons who soon were overwhelmed with work and were no longer able to cope. The emasculation of the Assistant Secretaries' responsibilities and the increased independence of the Regional Administrators (RA) are prime examples of ill defined responsibilities. Although the Assistant Secretaries are responsible for policies and development of regulations, they and their staffs could no longer order the field offices to follow those policies or regulations. They became staff personnel with no direct line authorities. The Regional Administrators bypassed the Assistant Secretaries and reported to the Undersecretary and the Secretary. Obviously, a strong RA could, and some did, operate within their regions with almost total independence while in a region supervised by a weak RA, chaos could prevail when each office acted independently.

Allocation of resources was often done without careful evaluation of the workload or experience of local office personnel. The Assistant Secretary for Administration was given such authority over expenditures that other Assistant Secretaries were unable to purchase equipment or supplies to support their staff. Finally, funds were not available for training and necessary travel were cut below acceptable levels.

2. MONITORING: It became clearly evident during the 80's that HUD did not have the resources nor the personnel to adequately monitor the implementation of its programs. In certain instances, management review inspections were postponed because travel funds were unavailable. In other cases, the personnel making the inspections were so new and inexperienced that improper conclusions were reached, and recommended actions may have exacerbated the problem. In the overwhelming majority of cases, credit must be given to the private sector which attempted to carry out the intent of the programs, sometimes against overwhelming odds. One of the major problems was that certain members of the Administration believed that if multifamily projects failed or were foreclosed upon and disposed of, this would reduce the existing housing inventory and, thus, further budget reductions. These actions were part of the grandiose scheme to take the government out of the housing business.

We are all too painfully aware of those instances of abuse, mismanagement and fraud which received media attention in the waning days of 1989. Undoubtedly more careful monitoring would have prevented some of those problems. Others, however, were inherent to basically flawed programs such as coinsurance. These were initiated by an administration desiring to reduce the government's role in housing at any cost.

The major steps which should be taken to prevent any future abuse, mismanagement and losses, are hiring competent, dedicated staff; providing such staff with adequate resources to perform their functions; and giving proper and adequate recognition to those who excel in achieving well defined departmental goals. That is, to provide additional decent, safe and sanitary housing to those who need it.

3. DATA MANAGEMENT/INFORMATION SYSTEMS: There is no question that data systems available to HUD were inadequate. In the past 10 years, every time a new data reporting system was announced, with great fanfare, actual installation and usage was delayed for

months, sometimes years. Only recently have I seen sufficient PC's made available to HUD professionals at headquarters. Yet HUD encouraged and in some cases ordered management agents to provide their project offices with those same PC's which they did not have.

Approximately 4 years ago, HUD announced a program to receive all voucher requests and handle the assistance payments electronically. The Department planned to do so because it could no longer deal with the mounting paperwork which it received in its field offices. This program has not yet been implemented because the field offices do not have the hardware or operating software to implement the program. If the original determination was accurate, that electronic transmission was necessary, then obviously, inadequate monitoring has taken place since that time.

Mr. Chairman, these are some of the issues on which I have personal knowledge and which answer the questions posed by your staff. However, in conclusion, I would like to reiterate the statements which I made earlier. It is essential that the Administration and the Congress, working together, define clear goals to deal with the housing problems of this nation. The Secretary, Under Secretary, and Assistant Secretaries, all appointed by the President and confirmed by the Senate, should be given adequate resources and the freedom to move the Department forward to these goals.

We have investigated past errors and abuses, enacted the HUD Reform Act and given the Secretary authority to deal with those who willfully violate their agreements. I strongly urge the Congress to provide the Secretary and HUD the resources which they need, even thought they might not have expressed this need clearly.

Now is the time for the Congress and the Administration to work together to address all of our housing needs, particularly those of the homeless. If we are going to solve the nation's housing problems within a reasonable period of time, we should be willing to allocate to housing the funds which it needs. I know that solving housing problems may not allow us to meet the goals of Gramm-Rudman within the scope of current available revenues. However, we must invest in housing because if we do not, it will be far more difficult to solve the other problems facing this nation, such as drugs, poor education, unemployment and lack of basic job skills. Without a decent home, our children will not live in an environment to deal with those problems.

This concludes my testimony, and I would be glad to answer any questions you may have about my statement.

Senator **Graham**. Thank you very much, Mr. Grady.

Mr. Koelemij.

STATEMENT OF JOHN KOELEMIJ, PRESIDENT, ORANGE STATE CONSTRUCTION CO., TALLAHASSEE, FL, FOR THE NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. **Koelemij**. Senator Graham, Senator Mack, who are both from my great State of Florida and, by the way, Senator, we don't need his help. We can do the job. [Laughter.]

My name is John Koelemij. I'm a builder from Tallahassee, FL. I'm also a past president and a member of the board of directors of the National Association of Home Builders. I have built and presently own and manages subsidized housing units.

I appear before you today as a private sector builder to focus on the staffing and the resource capacity of the Department of Housing and Urban Development, based largely on my own personal experience, but also enhanced by information I have received from builder members in my capacity as a former officer and president of NEHB. I am pleased to provide the following response.

Mr. Chairman, I had a prepared statement and I ask that be made part of the record, and I'll make a few comments.

Senator **Graham**. It will be, and all of the prepared statements that are submitted will be included in the record. And the record will be held open for 30 days if there were any supplemental comments that you wish to be included.

Thank you.

Mr. **Koelemij**. Thank you.

The general perception that HUD suffered a brain drain during the eighties is largely correct, as a select number of key employees who possess significant experience and technical expertise did depart public service for opportunities in the private sector.

The result, in all fairness to the dedicated employees who have remained at HUD, however, is that this consequence has not resulted in a HUD that is brain dead.

Budget cuts within HUD and overall reduction in the Federal work force contributed to the loss of numerous key, seasoned employees, but perhaps the tone or the loss of stated purpose as to the importance of a strong Federal role in housing contributed to an even greater degree.

There was no motivation or leadership pressure to do the best job possible or to create pride in the function of the Department of Housing.

Many builders, owners and managers of both single-family and multifamily properties experienced unnecessary delays in program implementation during the 1980's. And while the administration continued to proclaim that low-income housing was within the Nation's safety net, it now appears that the framework to operate these programs was not within that net.

That is, when single family housing activities skyrocketed, as reduced interest rates enabled many families of modest means either an opportunity to purchase needed housing or to refinance mortgages without very high interest rates, staff resources needed to meet this demand were nowhere to be found.

Likewise, when housing markets collapsed in several areas of the country, both single family and multifamily properties flooded a Federal department that was both understaffed in the terms of quantity as well as quality and experience.

The result may very well be that the Federal Government experienced far greater losses than would have been necessary had staff resources been able to meet the impending crisis.

Responsible and adequate monitoring of any bureaucracy will perhaps always be a problem, whether within the public or private sector. There exists a delicate balance between the need to monitor programs and activities and the need to permit individual initiative and growth.

As the bureaucracy grows, the need to oversee the overseers also grows. But there are accepted limits and the benefit cost analysis of the last administration in the area of housing does not appear healthy.

The policies of HUD that led to contracting out direct endorsement, coinsuring mortgages and others enabled HUD to reduce staff at the Federal level, to implement these various programs, but it did not or should not have left HUD incapable of monitoring these advanced programs which were equally, if not more capable of abuse once responsibility was transferred either wholly or in part to the private sector.

It would be a mistake, if not an outright misstatement, to claim that HUD ever possessed even adequate data management and information systems. HUD relies on lenders, appraisers, local housing authority and housing finance agencies to accomplish its data management goals.

Having said this, however, we cannot excuse HUD from its lack of profit monitoring in various areas.

While I think the record leaves little room for doubt that the Department did not possess the capacity to monitor adequately and effectively the many programs it administers, Department policies may very well have encouraged the inability to fairly and effectively monitor a number of programs.

Part of this may have been driven by reductions in staff and equipment. Part was apparently also to diminish the ability of others, both Congress and outside interests, to refute HUD's claims.

I fully realize that argument of whether bad programs or bad policies led to the many problems at HUD over the last decade will not be decided ultimately by this hearing or perhaps even by this Congress, but I do believe that, in many instances, it was not acting alone.

The effect of these policies is quite clear:

Too many of the reduced Federal dollars to house the Nation's needy did not make it to the family in need, much less the family most in need.

The effect is a sad commentary on our ability to properly house all families in an affordable manner.

I do not know if OMB has the same control of other departments as it has applied to HUD. But, through its actions, it has for many years made it very difficult for HUD to spend the appropriated funds in a timely manner.

While it is vitally important to look back and correct the abuses of the past, it is also vitally important to provide assistance to those who are in need of affordable shelter now and in the future.

Recent, abrupt cancellations of programs without any transition period are holding up projects in the pipeline, and many of these projects will not survive if they stay there any longer.

After having experienced the devastating impact on multifamily housing through passage of the 1986 Tax Reform Act, the so-called moratorium on prepayments and unsure conditions surrounding the continued support for and a renewal of project-based section 8 contracts, the sudden cancellation of the Mod Rehab Program and the adverse impact of the passage of FIRREA which that is having on real estate loans availability has led to an atmosphere where capital resources for financing of low and moderate income housing facilities have dried up.

Government support and commitment is needed now to correct this. I'm encouraged by the tone of Secretary Kemp's words and I look forward to the full implementation of those goals which we share, which no doubt need the full support of the Congress.

The answer lies not only in providing adequate resources to house the Nation's lower and moderate income families, but also in providing an adequate framework to implement the system and thereby enable this Nation to house its diverse population in a safe, sanitary and affordable manner.

Mr. Chairman, this concludes my opening statement. And I will be ready to answer questions.

[The complete prepared statement of John J. Koelemij follows:]

STATEMENT
of
JOHN J. KOELEMIJ
before the
SENATE INVESTIGATION SUBCOMMITTEE
of the
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
on
STAFFING AND RESOURCE CAPACITY OF HUD
April 20, 1990

Mr. Chairman and Members of the Subcommittee:

My name is John Koelemij, and I am a builder from Tallahassee, Florida. I am also a past President and a member of the Board of Directors of the National Association of Home Builders. I have built, and presently own and manage, subsidized housing units.

I appear before you today as a private-sector builder to focus on the staffing and resource capacity of the Department of Housing and Urban Development (HUD).

The letter of invitation suggests that the intent of this inquiry is to identify the problems HUD has experienced, the causes of those difficulties, and the actions necessary to rebuild the Department. Four areas of concern are outlined: Capacity and Skill Levels, Administration and Implementation, Monitoring, and Data Management and Information Systems.

Based largely on my own personal experience, but also enhanced by information I have received from builder members in my capacity as a former officer of NAHB, I am pleased to provide the following response.

CAPACITY AND SKILL LEVELS

The general perception that HUD suffered a "brain drain" during the 1980's is largely correct, as a select number of key employees, who possessed significant experience and technical expertise, did depart public service for opportunities in the private sector. The result, in all fairness to the dedicated employees who have remained at HUD, however, is that this consequence has not resulted in a HUD that is "brain dead."

Budget cuts within HUD and overall reduction in the federal work force contributed to the loss of numerous key, seasoned employees, but perhaps the "tone", or the loss of stated purpose as to the importance of a strong, federal role in housing, contributed to an even greater degree.

For many of those who had dedicated more than a decade to building a federal capacity to address the nation's housing needs, it was no doubt devastating not only to witness, but also to experience, an abandonment of existing policy, while allowing a vacuum, or "black hole" to take its place.

ADMINISTRATION/IMPLEMENTATION

Many builders, owners, and managers of both single-family and multi-family properties experienced unnecessary delays in program implementation during the 1980's. While the Administration continued to proclaim that low-income housing was within the nation's "safety net," it now appears that the framework to operate these programs was not within that net. That is, when single family housing activity skyrocketed, as reduced interest rates enabled many families of modest means either an opportunity to purchase needed housing or to refinance mortgages with very high interest rates, staff resources needed to meet this demand were nowhere to be found. Likewise, when housing markets collapsed in several areas of the country, both single-family and multi-family properties flooded a federal department that was both understaffed in the terms of quantity, as well as quality and experience. The result may very well be that the federal government experienced far greater losses than would have been necessary had staff resources been able to meet the impending crisis.

Not only did the federal government lose more than was necessary from a financial perspective, but far too many families lost their right to basic shelter and became again exposed to serious problems such as drugs, poor eduction, and unemployment, because, without a decent living environment, it is much more difficult to deal with these problems.

MONITORING

Responsible and adequate monitoring of any bureaucracy will perhaps always be a problem. Whether within the public sector, or within the private sector, there exists a delicate balance between the need to monitor programs and activities and the need to permit individual initiative and growth of a positive nature. No one wants a total police state. And as the bureaucracy grows, the need to oversee the overseers also grows. But, there are accepted limits, and the benefits/cost analysis on the last Administration in the area of housing does not appear healthy.

The policies of HUD that led to "contracting out," direct endorsement, co-insuring mortgages and others, enabled HUD to reduce staff at the federal level to implement these various programs, but it did not, or should not have left HUD incapable of monitoring these "advanced" systems which were equally, if not more, capable of abuse once responsibility was transferred, either wholly or in part, to the private sector.

A similar event occurred when both the tax-writing committees in Congress and the authorizing committees independently chose to reduce assistance to lower-income rental housing construction. Neither policy in itself was devastating, but when combined, the result was, and is, that very, very few new units of badly needed low-income housing are being built, and far too few are being adequately maintained.

The fault lies not only with the Reagan Administration; some blame must also be shared by the Congress and with the industry, as well.

DATA MANAGEMENT/INFORMATION SYSTEMS

Again, the prior Administration can and should take its share of blame for the problems associated with data management and information systems, or rather, the lack thereof.

It would be a mistake, if not an outright lie, to claim that HUD has ever possessed even adequate data management and information systems. By its very nature, HUD relies on lenders, appraisers, local housing authorities, and housing finance agencies to accomplish its data management goals. As technology advances in this area, some firms, governments and agencies purchase and develop varying systems to meet their individual needs. The result, however, is that what one entity can afford and need, a New York City, for example, may not be what my own community of Tallahassee, or even the state of Florida may purchase and develop. When HUD later determines that various data is needed, some are at a disadvantage in being able to supply the needed information, even though it may lie at their very fingertips.

For example, when HUD wants information, it usually wants to receive it in a very specific manner -- so it will be compatible with their own information systems. For an entity such as New York City to reprogram and reformat existing data to conform to HUD's needs is very expensive. It is no less so for a small lender, or apartment owner.

Having said this, however, we cannot excuse HUD from its lack of proper monitoring in various areas. While I think the record leaves little room for doubt that the Department did not possess the capacity to monitor adequately and effectively the many programs it administers, Department policies may very well have encouraged the inability to fairly and effectively monitor a number of programs. Part of this may have been driven by reductions in staff and equipment, part was apparently also to diminish the ability of others, both Congress and outside interests, to refute HUD claims.

It is very costly for an apartment owner to refute that the HUD Fair Market Rent in an area is neither fair nor market rate, even though the owner/manager may know that this is the case. By the same token, if insurance data is combined into one printout batching too much information together, then neither HUD, nor Congress, nor the American public is able to ascertain which programs are having problems, where the problems are, or how best to correct the situation. The result is wholesale termination of programs, which look very costly on paper, but which may have gone bad only in very limited situations, or in certain geographic areas that were experiencing very unique economic circumstances.

CONCLUSION

I fully realize that the argument of whether bad programs or bad policies led to the many problems at HUD over the last decade will not be decided ultimately by this hearing, or perhaps even by this Congress. But, I do believe that in many instances it was not acting alone. The effect of the these policies is quite clear. Too many of the reduced federal dollars to house the nation's needy did not make it to the family in need, much less the family most in need. The effect is a sad commentary on our ability to properly house all families in an affordable manner.

I do not know if OMB has the same control of other Departments as it has applied to HUD, but through its actions, it has for many years, made it very difficult to spend the appropriated funds in a timely manner.

While it is vitally important to look back and correct the abuses of the past, it is also vitally important to provide assistance to those who are in need of affordable shelter now and in the future.

Recent abrupt cancellations of programs without any transition period are holding up projects in the pipeline and many of these projects will not survive.

After having experienced the devastating impact on multifamily housing through passage of the 1986 Tax Reform Act, the so-called moratorium on prepayments and the unsure conditions surrounding the continued support for and renewal of project based Section 8 contracts -- the sudden cancellation of the Moderate Rehabilitation Program -- and the adverse impact the passage of FIRREA is having on real estate loans availability, has led to an atmosphere where capital resources for financing of low- and moderate-income housing facilities have dried up. Government support and commitment is needed now to correct this. I am encouraged by the tone of Secretary Kemp's words, and I look forward to the full implementation of those goals that we share, which no doubt, need the full support of the Congress. The answer lies not only in providing adequate resources to house the nation's lower and moderate income families, but also in providing an adequate framework to implement the system, and thereby enable this nation to house its diverse population in a safe, sanitary and affordable manner.

This concludes my testimony, Mr. Chairman. I welcome any questions that Members of the Subcommittee may have.

Senator **Graham**. Thank you, Mr. Koelemij.

Mr. Chappelle.

STATEMENT OF BRIAN CHAPPELLE, STAFF VICE PRESIDENT, RESIDENTIAL FINANCE/GOVERNMENT AGENCY RELATIONS, MORTGAGE BANKERS ASSOCIATION, WASHINGTON, DC

Mr. **Chappelle**. Thank you, Mr. Chairman. My name is Brian Chappelle. I'm a staff vice president with the Mortgage Bankers Association of America, and I would like to highlight some of the points in my prepared testimony.

I would like to begin with excerpts from an organization's annual reports for the 1980's:

> Gross sales tripled. In one year alone, it collected over $3 billion of income. Staff productivity more than doubled.

Doesn't this sound like a Fortune 500 company on the rise?

Unfortunately, these highlights only tell half the story. If this was, in fact, a Fortune 500 company, its CEO would have been given all the resources necessary to handle its increased volume.

However, this organization is the Federal Housing Administration. And, instead of giving its managers the resources necessary to carry out its duties, FHA decimated its staff through a series of administrative actions which included freezes on hirings and promotions, downgrading efforts and a lack of adequate training and travel funds.

MBA recognizes that FHA can't be expected to have the staff employee compensation packages and support services of a Fortune 500 company. However, we do believe that FHA deserved far more support than it received during the 1980's. That is why we are so appreciative of your efforts, Mr. Chairman, in holding these hearings, so that we may, hopefully, avoid these problems in the future.

In your letter, Mr. Chairman, you made repeated references to the brain drain at FHA. Here are some examples that prove your point.

There were several findings from a survey in 1985 that was conducted at HUD.

First, 22 percent of all FHA field staff had been in their current job for less than 1 year. This underscores the lack of experience which existed at FHA. It reflects the freeze on outside hirings and how staff without any specialized experience were moved to FHA from other sections of HUD. No matter how hard-working these people were, and many were dedicated, they simply were not qualified to hold these highly technical positions.

Second, about 25 percent of all supervisors in the appraisal and underwriting areas had less than 1 year's experience. This underscores the fact that there frequently was no one in the field office who could make decisions.

Finally, about 55 percent of all appraisers were over 50 years old. This underscores the fact that HUD was unable to develop any new talent because of the prolonged freeze in hiring.

In addition to the survey, FHA staff making $30,000 a year were reviewing the work of people in the private sector making three or four times that amount.

This underscores the fact that HUD could not attract staff because of its pay structure.

Finally, travel funds were so scarce that FHA had to hire contract employees at up to four times the expense to perform field inspections, which staff could have performed if travel funds were available.

The impact of these problems on the industry was devastating. Because of the general staff shortage and lack of experienced staff, backlogs developed in all of the critical processing areas in multifamily and single-family housing.

Because field office staff were inexperienced, they were afraid to make decisions—or simply said "no" to everything.

They imposed arbitrary and often conflicting local requirements on the lenders, which made life unnecessarily difficult for people doing business with FHA.

Mr. Chairman, MBA requests that the subcommittee consider the following proposals in your deliberations:

First, increase the number of permanent fulltime staff, particularly in the field offices. With the demise of the multifamily coinsurance program, FHA needs field employees who are skilled in this technical area. They cannot solely be bodies from other parts of HUD.

Second, improve the quality of the staff through the revision of the pay structure along the lines of FDIC or OCC. HUD staff functions have changed dramatically from processing to reviewing, monitoring, and training. Their compensation must be revised accordingly.

Third, increase funds for training and travel. Finally, consolidate certain functions in regional locations. This will enable HUD to realize economies of scale and provide better service.

In conclusion, Mr. Chairman, FHA still has many good employees, but they need help. Because of the efforts of your subcommittee, hopefully, they will get it.

Thank you very much for the opportunity to testify before you today.

[The complete prepared statement of Brian Chappelle follows:]

1125 Fifteenth Street, N.W.
Washington, D.C. 20005
202-861-6500

Mortgage Bankers Association of America

STATEMENT OF

BRIAN CHAPPELLE

**Staff Vice President, Residential Finance and
Government Agency Relations Department**

of the

MORTGAGE BANKERS ASSOCIATION OF AMERICA

before the

HUD INVESTIGATION SUBCOMMITTEE

SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

Hearing on

STAFFING AND RESOURCE CAPACITY

April 20, 1990

Mr. Chairman and Members of the Subcommittee, my name is Brian Chappelle and I am Staff Vice President, Residential Finance and Government Agency Relations Department for the Mortgage Bankers Association of America (MBA)*. Accompanying me today are Michael Ferrell, MBA's Senior Staff Vice President and Legislative Counsel and Ann vom Eigen, MBA's Associate Legislative Counsel.

MBA appreciates the opportunity to testify before the Department of Housing and Urban Development (HUD) Subcommittee on the important issue of staffing and resources. We believe that staffing and resource restraints have already affected the quality of HUD program delivery, oversight, and monitoring. Unfortunately, we believe that staffing and resource constraints may be a continuing problem for HUD and we have, therefore, attempted to identify solutions that address HUD's problems within likely funding constraints.

As requested, responses to the questions which you asked us to address, where applicable to our members, are listed below:

---

*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of residential and commercial real estate finance. MBA's membership comprises nearly 2,600 mortgage originators and servicers, as well as investors, and a wide variety of mortgage industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, selling, and servicing real estate investment portfolios.

Members of MBA include:

- Mortgage Banking Companies
- Commercial Banks
- Mutual Savings Banks
- Savings and Loans Associations
- Mortgage Insurance Companies
- Life Insurance Companies
- Mortgage Brokers
- Title Companies
- State Housing Agencies
- Investment Bankers
- Real Estate Investment Trusts

MBA headquarters is located at 1125 15th Street, N.W., Washington, D.C. 20005; Telephone: (202) 861-6500.

1. CAPACITY AND SKILL LEVELS: It is generally perceived that during the 1980's, HUD suffered a "brain drain" in which a large number of employees possessing significant experience and technical expertise left the agency. This phenomenon was caused by a number of factors, including budget cuts and overall reductions in the Federal work force.

a. What additional factors contributed to the deterioration of staff capacity (i.e. Reagan Administration policies)?

Budget and management policies that achieved savings in personnel by attrition prevented HUD from obtaining the new personnel and the new ideas and approaches to problems that are vital to every organization. Hiring freezes and budget restraints also meant that people with specific skills could not be recruited. Moreover, frequent freezes on promotions meant that HUD staff had to go to other Federal agencies for promotions and, therefore, FHA vacancies that occurred were filled by staff on detail.

In the New York Office, for example, 12 key positions were filled by staff on detail in 1986. The grade structure also imposed salary limitations drastically inappropriate for the functions performed. For example, in the appraisal area, HUD employees receiving a salary of $30,000 per year were reviewing the work of contract appraisers who were being paid over $80,000 per year.

In addition, support resources, such as travel funds, were unavailable. This created significant monitoring and oversight problems for certain functions, such as multifamily appraisals, where on-site visual inspections are key to an accurate assessment of the value of the insured property. In the single family area, fee contractors had to be used to perform appraisal reviews because travel funds were not available to permit field staff to perform these responsibilities. This problem is still occurring today.

Training funds that would have allowed new staff to achieve a better understanding of the real estate market they were dealing with were also unavailable.

b. How have changes in the numbers, skill levels, experience of staff affected your dealings with the agency?

The most significant problem for our members was the reduction in the skills and experience of HUD field staff. Seasoned professionals with expertise and the ability to make qualitative judgments left HUD. As indicated below, this delayed responses to questions. Coupled with processing delays due to inadequate numbers and skills, these delays meant that many multifamily projects became economically infeasible. In 1985, 22 percent of all Housing staff had been in their current positions for less than one year. About 25 percent of the Chief Appraisers and Underwriters had less than one year's experience.

c. How did cuts affect the quality of work performed?

Staff with little experience or understanding of mortgage finance and insurance were placed in critical jobs. This has created problems for mortgage lenders who have questions requiring interpretation of HUD policies or "unusual" regulations. If anything atypicai arises, lenders must contact Washington for guidance. Lenders doing business with several HUD offices are continually frustrated by the inconsistency in field office requirements.

d. How has HUD's decline in staff and other resources affected the agency's ability to respond to problems in a timely and effective fashion?

In the single family Section 203(b) insurance program, HUD has delegated many functions to lenders. However, FHA is no longer able to provide critical services, such as subdivision and condominium processing. Lenders are encouraged to go to VA for timely service. Another major problem appears to be personnel shortages in the servicing area. Here, lenders have had problems with HUD post claim audits and HUD requirements for indemnification.

In the multifamily full insurance programs, where HUD personnel must perform all document review and analysis functions, processing delays due to inadequate or untrained staff can reach as much as two years in some offices. HUD lost many knowledgeable people in supervisory positions. We found they were replaced with people who were not qualified to fill those positions and, therefore, could not provide the training or leadership necessary to run the operations effectively.

We believe the coinsurance programs were instituted, in part, because of staffing restraints. Coinsurance allowed HUD to continue insuring affordable housing units in a timely manner with significantly fewer staff. However, HUD failed to provide the necessary oversight and management to ensure a successful program.

In light of the cutbacks in multifamily insured development, from about 800 to 200 employees, MBA is concerned about HUD's ability, under the proposed delegated processing concept, to provide prompt service in the future.

e. What critical functions (i.e. underwriting, appraisals) suffered the most from the "brain drain"?

Technical experts in the appraisal and underwriting areas of both single and multifamily housing were the most hard-hit by the "brain drain." This was because their skills were easily transferable and HUD experience was very valuable to lenders. Housing production and management directors with excellent skills were also very attractive to the private sector and left HUD for better opportunities. In one HUD office, the only person with a college education was the manager. That office insured over $1 billion in loans in 1987.

2. ADMINISTRATION/IMPLEMENTATION: Witnesses at prior Congressional hearings have testified that HUD lost much of its capacity to carry out its duties in a timely and effective fashion. A 1986 report compiled by HUD's Regional Administrators on staffing gave several examples of weaknesses in the agency's ability to administer and implement its programs. For example, in Single Family Housing Development and Single Family Loan Management, serious backlogs were reported. As a result, processing was slow, important tasks were not being performed, and the quality of HUD's processing and review functions was significantly reduced. In Multifamily Property Disposition, administrators cited serious problems with inadequately trained staff. Public Housing also reported problems due to understaffing.

a. What problems did you encounter with HUD's implementation and administration of its programs, and what factors contributed to those problems?

HUD lacked the support resources (primarily training and travel funds) to implement new programs properly. Field office staff were not adequately trained. Accordingly, they could not train lenders' staffs adequately. They lacked the travel funds to present these new programs to the industry. With regard to the problems for the industry, HUD lacked the resources to give lenders equal access to the program. For example, in the coinsurance program, lenders who were not among the first to get applications, had to wait months for FHA approval, and were at a distinct competitive disadvantage in the interim. In the coinsurance program, the lack of travel funds limited HUD's ability to perform program oversight and monitoring, and to conduct enforcement.

Further, possible program improvements that required hard data and analytical review were considered "frills" which could not be addressed. Consequently, the agency stood still, or went backwards, rather than making progress on program improvements.

b. What flaws in the design and implementation of the program delivery systems created problems and how could they be remedied?

On the multifamily side, there were numerous flaws in the implementation of program delivery. For full insurance, there is inadequate staff in most field offices to process an application on a timely basis. For coinsurance, delays were experienced in the few functions that FHA performed (e.g. market analysis and environmental reviews), and we have seen the results of inadequate monitoring of coinsured lenders. In the original design of the coinsurance program, not enough thought was given to the claims process and the major liquidity requirements for lenders with loans in default. Some provision should have been made for an earlier payment of some portion of FHA's share of the loss--particularly considering how bankruptcies can delay foreclosures.

In addition, several other tools available under the full insurance multifamily programs, e.g., work out assistance and operating loss loans, could minimize losses under the program.

c. What critical functions (i.e. underwriting, appraisals) suffered most from the "brain drain"?

Appraisers and underwriters, who have skills that are most transferrable and in demand by the private sector, were the most likely to leave HUD.

Staff with little experience or underwriting of the real estate industry were placed in critical jobs. This has created problems for mortgage lenders who have questions requiring interpretation of HUD policies or "unusual" regulations. If anything atypical arises, lenders must contact Washington for guidance.

d. Were the roles and responsibilities in program implementation clearly defined between Headquarters, Regional, and Area Offices, and did each have the resources to carry out their duties?

There has been a long-standing problem regarding the specific roles and responsibilities of the various offices. While regional offices had line responsibility over the field offices, the assistant secretaries (e.g. FHA Commissioner) had program responsibility for carrying out the provisions of the National Housing Act. From our perspective, both Headquarters and Field Offices are inadequately staffed.

3. MONITORING: The intent of monitoring is to ensure that programs are properly administered and properly serve their intended beneficiaries. The 1986 Regional Administrators' study indicated that in an era of reduced staffing and resources, often the monitoring function suffered greatly.

a. Did HUD ensure compliance with obligations undertaken by private and public entities in exchange for federal subsidies?

This is not applicable to our members.

b. In particular, did HUD ensure that housing developed with federal assistance served its intended beneficiaries and was maintained in a decent, safe, and sanitary condition?

This is also not applicable to our members.

c. Could better monitoring have prevented abuse, mismanagement, and financial losses to the agency?

MBA, as a trade association, wrote to HUD in 1986, in response to alarming default rates in the coinsurance program (letter attached) suggesting several changes, including increased enforcement. Quite frankly, monitoring techniques were not the most serious problem. It was the "will" to enforce the existing rules effectively. Another problem that our members have mentioned is HUD's emphasis on review of lenders' form rather than substance. From our experience, oversight and audits have often focused on technical compliance with the completion of the forms, rather than a qualitative assessment of the information provided. This problem is another negative fall out of the "brain drain" and problems that stem from the inexperience of the remaining HUD staff.

d. What would you recommend to improve monitoring to prevent abuse, mismanagement, and losses?

The most important item to prevent the problems discussed above is stong leadership from the Secretary's Office and an equally strong commitment to address the nation's housing needs in a reasonable, fair, and timely manner.

In addition, our members are frustrated by the subjective judgements of inexperienced staff. We would like to see more objective criteria used to review lender performance. Early default and claim tracking of local markets should provide HUD with information to identify problem lenders early in the process. Increasing the grade levels and, therefore, financial renumeration of staff assigned monitoring responsibilities, as well as increasing training and travel funds for this staff, would improve the quality of staff and, therefore, the monitoring.

4. DATA MANAGEMENT/INFORMATION SYSTEMS: Several witnesses have testified that data systems were inadequate to properly monitor HUD's programs and the health of its finances.

For example, in an analysis done of the FHA, Price Waterhouse stated that the data systems used by HUD were woefully inadequate to monitor the health of the FHA fund.

a. What information did HUD need to ensure that programs were implemented in a fair and effective fashion (i.e. fair market rents, determination of appropriate levels of subsidy, etc.)?

With regard to FHA's single family program, HUD needs to monitor the causes of default more carefully. While the CHUMS system has proven to be an excellent tool to help field offices to track cases, it could be used to collect valuable risk information, including information on borrower credit history, use of gift letters, and other potentially high risk items. With this information, HUD could analyze the causes of claims more carefully and, therefore, make prudent changes to their programs.

b. Did HUD possess adequate data systems to effectively administer and monitor its programs?

HUD has made a conscious effort to upgrade its data systems in the 1980s. However, the speed with which these actions were implemented was delayed because of the budget constraints that affected all HUD's resources.

The CHUMS system (for FHA single family programs) appears to be functioning adequately. In addition, our multifamily members provide substantial information about their portfolios and their companies to HUD, which should be adequate for most monitoring purposes. However, our experience in working with HUD to attempt to develop solutions to the coinsurance problem has shown that HUD has been unable or unwilling to retrieve, and, therefore, analyze that data. Perhaps this is a function of inadequate data systems.

Recommendations:

MBA has the following recommendations to improve the HUD staffing situation.

1. Increase the number of permanent full time staff, particularly in the field offices.

With the termination of the coinsurance program, FHA field staff will be responsible for more of the processing of multifamily insured projects. Unfortunately, field staff has declined drastically from about 800 to a little over 200 employees for this critical function. If HUD is to provide timely and quality responses, it must have more staff and they cannot solely come from other parts of HUD. They must be highly skilled, experienced individuals.

2. Improve the quality of FHA staff.

The grade structure for determining salaries should be revised. FHA staff should be treated as other Federal employees in financial related industries (e.g. the FDIC) and should be given premium pay. In addition, HUD staff functions have changed from purely technical, to analyzing and reviewing the work of those in the private sector and training private sector employees on HUD requirements. These are far more difficult duties.

3. Increase FHA travel funds for critical field office monitoring, reviewing and training responsibilities.

4. Increase funds for training of HUD staff.

While improvements have been made in recent years, the complexity of the mortgage business demands ongoing training of field office technicians and supervisors.

5. Consolidate certain functions in regional locations.

With the delegation of responsibilities to the private sector, it is not necessary to have HUD staff performing the same functions in 81 field offices. Instead of having two people performing underwriting reviews in 81 locations, perhaps seven people in 20 offices could carry out these duties. Similar economies-of-scale could be realized in the servicing area.

From the industry's perspective, these personnel would generate more consistent decisions and eliminate unnecessary differences in interpretations.

Senator **Graham**. Thank you very much, Mr. Chappelle, and to each of the members of this panel.

Each of you represents either a public or private agency or association whose members have had a long association of partnership with the Department and its various programs.

There has been in some of our previous hearings comments at a decline in the confidence level of those private sector or State and local partners in HUD.

Mr. Chappelle has suggested some of the prescriptions. I'd be interested in other comments as to what you think needs to be done in order to restore a sense of confidence in the HUD partner, who is going to be a necessary element in our national effort to provide affordable housing.

Mr. **Siflinger**. Well, why don't I begin.

I think HUD really has to figure out what it can do and what it should do given potential available resources.

Question one: Will we, in part, go back to the high production days of the 1970's?

Of course, you in Congress will make that decision.

I think it's fair to say, and most people would agree, that at the present time, HUD does not have the quantity and quality of staff that it needs to carry out its underwriting and monitoring responsibilities.

The concern expressed by Mr. Hipps in the previous panel about the ability of the Civil Service System to attract and maintain over a long period of time a quality staff is, in my opinion, valid. I think it's a serious issue.

I think people currently stay with HUD because of individual dedication and commitment. The pay scale, as well as the mission, is not competitive with what we at the State agency level can provide, and certainly not competitive with the private field.

I would recommend generally a process whereby HUD assumes its traditional role of policy development based upon statutory authority that is given to it by—I lapsed into "us"—given to it by the Congress and assume generally a responsibility for monitoring.

But I think it should delegate, and this may sound self-serving, but I think it should delegate certainly to State agencies that have the capacity to underwrite on the various programs, that have the capacity to manage or supervise the management of housing.

That responsibility I believe should be delegated to those public agencies at the State and the local level that can carry out that responsibility. I think HUD should determine whether or not the public agency has that capacity or can acquire the capacity and, if so, to delegate—and monitor—that's the key. It must monitor. It must evaluate. It must have the staff capacity to carry out those functions.

And I think, to expect to rely on the civil service system to carry out responsibilities on a project by project basis in our 50 States is long gone. And I might also say I agree with Mr. Chappelle's points and, as I indicated, I would supplement it, you know, just with my comments.

Senator **Graham**. Mr. Grady.

Mr. **Grady**. Mr. Chairman, I think that what needs to be done is to certainly have a very clear indication on the part of Congress and the administration together that HUD and the Federal Government are in the business of providing adequate housing to stay.

For much too long we have heard that we wanted to get the Federal Government out of the housing business, and I think that this has to be clarified, because you cannot attract to a department qualified personnel if they are going to be attracted just to oversee the dismantling of an institution and the dismantling of a program. Very few people want to come and just preside over a funeral.

I think that it has to be made very clear that we want to continue as a matter of national policy the partnership which created all of the housing that we saw in the 1960's and the 1970's, and that we want to continue to attract the private sector to work in connection with and together with the public sector to build and maintain and preserve the housing that we have today, and to build additional ones where needed.

Finally, we have to motivate the staff of HUD. It is true that the Federal Government will not be able to manage what is being paid outside of the Federal Government, but I think that just as Mr. Siflinger said that when he was a young man he wanted to go to FHA because of what it meant, there are ways in which we can—if we show that there is a meaningful purpose to the employment—attract dedicated personnel.

Whenever I am not a home builder, I am a trustee of a college and I know that, for instance, we attract teachers for other than just purely monetary rewards. But we have to have a goal. We have to have a purpose. It has to be implemented not only in words but also in deeds, and we have to move forward and know where we are going.

This I believe is important to do right now. It is something which we can do this year with the leadership we have at HUD if the Congress and the Nation are willing to devote sufficient resources to implement this policy because we cannot do it only with words.

Mr. KOELEMIJ. Mr. Chairman, I agree with what both of them have said. In looking at it a little bit from a personal experience point of view, I remember that I came to this country in 1954 and I embraced the opportunities that this country offers and I delved into it right away, and I have been successful at doing that. I have worked hard to accomplish it.

When I was building and selling homes from price ranges that started at $8,290, I also found people in my community that could not afford to buy that home. We had public housing, and as business people we said public housing is bad; we should cut the appropriations for public housing. It should be done by private enterprise. So finally in 1967–68 when the Housing Act was passed, we said, there are other ways to provide low-income housing and it can be built by private enterprise with the support of the Federal Government.

That is when I became involved in building the first project in Tallahassee under the so-called "rent supplement" program. I have built some projects, believe it or not, for owners that were people of the minority group, and I did it for them strictly because I was able to get the construction at the bank, and I did not become an owner of that project. It is theirs. But I helped them do it at the request of the director of the office in Jacksonville. He said, minority people should also be involved in this process, and I believed in that.

And I have lived with—and the projects that I built and own, I have done them from 1969 till 1973, I still own them. I still manage them, and so on. I have seen the changes in the Department of Housing from dedicated people to people that ultimately those same people gave up. There was no more rah, rah, rah about housing. It became almost to feel as if it was not a good job anymore, or the purpose was not there. I even experienced that in my private life when I was a leading person in a great organization, the National Association of Home Builders. Some would frown upon those who were involved in providing subsidized housing. And I always have defended it because it is something that is needed.

I think that part of that whole demise that we have seen in the staffing and in the importance of HUD is basically what leadership do you give it? What purpose do you breathe into it and support it? And if people do not feel that they come to work and are doing a real worthwhile job, then their spirit disappears or diminishes.

I am really enthused about when I hear Secretary Kemp say all the things that he is saying, and I hope to God that the Congress will support him and will give him some of the funds that are needed to again give them a worthwhile purpose, even though all of the things that he is talking about maybe cannot be accomplished, but I think we are on the right track when we start to again make housing a purpose, a part of the purpose of what government is all about. Private enterprise cannot do it all. Government has to play a role.

Senator GRAHAM. Thank you, very much, John.

My time is up. Connie.

Senator MACK. Thank you, John. I was moved by what you had to say. In this environment, many times it is awful easy to get into political ideology and get into people trying to make points. That is certainly not my intention, and I am again very moved by what you had to say, but let me just ask a question from this perspective:

What do you think caused the dissolutionment, though? I mean, it wasn't—I guess in my opinion somebody did not just walk in one day and say we do not like housing in the country, so let's just get rid of it. It came out of maybe a sense that the programs we put together just were not working, that there is a feeling that the ideal that we had established and the programs that we had put in place really were not accomplishing that.

I would like to have a sense from you about what you sense took place that really just undermined, if you will, both the support for public housing and created in people's minds a dissolutionment that said, I am leaving. There is no sense in me staying around in this program any longer. It is not fulfilling to me, and I am leaving. So it is a very open-ended question, but I would be interested in your reaction.

Mr. KOELEMIJ. Well, it is difficult but, Senator, it is no wonder when we look at the budgetary numbers and we start at 1981 and we had maybe $34 billion of money that was available for housing, which in the 1990 budget went down to about $14 billion, and half of which is precommitted because of contracts.

And, believe you me, at the time in 1981 we in this industry said, we have got to do our share to bring down the budget deficits, and we gave in to cuts in various programs, and did less of it. But the various attempts that were made, for example, to privatize FHA, to put service fees on FNMA and Freddie Mac and so on, there was like a message as if Government has no role to play at all in housing. And believe you me, that is not possible. Government has got to remain and has to play a role in housing.

I served for some 8 years in Florida on a housing goals council, and we went from nothing to a successful housing finance agency. Last year, or the year before, we had the first I think funding of some of our sales programs. The shifting took place from the Federal Government to the State government. The State government became aware that we have to do something if we want to preserve problems in our community—or prevent them.

So I think it is a question of the budgetary impact that prevailed, and then of course the attitude to say that maybe it can all be done. There is no question that sometimes program will develop mistakes, but there are different answers than to say let's do away with it. Correct the mistakes. Throw out the bad guys. Give HUD the authority other than for closing on a mortgage to get rid of a bad owner-manager. Give them powers to get rid of that person if he does not do it right.

Then we prevent these bad reports that we now get to read. It is not all the fault of HUD; it is the fault of HUD maybe not having the ability to act properly, or to react properly, and it is the fault of those who misuse the programs. We are going to find that in all levels of where government is involved, or even private enterprise is involved.

Senator MACK. Thank you.

Mr. SIFLINGER. Senator, may I respond as one of those disillusioned people——

Senator MACK. Sure.

Mr. SIFLINGER [continuing]. Because I left HUD in 1983 after a nearly 25-year career with the Department. I think the philosophical approach of Secretary Pierce and the administration was that assisted housing was no longer—assisted housing production was no longer necessary, and that the housing needs of our low- and moderate-income people can be met only through a voucher system was the philosophical basis of that dissolutionment when many of us in the field and in HUD knew that with a very tight vacancy rate in our particular areas of the country that the only way we could deal with that issue, with the issue of providing decent, affordable housing, was to continue to build new housing, and to do it in a quality way.

The mission of HUD was emasculated, and with that it was a very clear message. I might say, in my background I was appointed as Director of HUD in the Ford administration, reappointed in the Carter administration, and stayed through almost 3 years in the Reagan administration not really believing that the administration was serious about it. It was so inconsistent with the bipartisan approach to housing that we had seen in HUD and FHA that many of us could not believe it, and the message did finally sink in.

And the States, as John mentioned, where they had the resources took over responsibility for production, and that is what you see for the most part with State initiatives.

Senator **Mack**. That kind of leads me to a sense that I got from listening to Mr. Grady. I do not mean to downplay the importance of money as far as people's pay, but it does sound like a lot of what has occurred was driven by attitude. I mean, all of us want to have more pay, but it seems like a lot of what happened in fact was a change in attitude. Would you agree with that?

Mr. **Grady**. Certainly. I do not downgrade the importance of pay, but even if you received the highest salary in the world if you come to work every morning and you have a feeling that you are wasting your time, you have a feeling that every time you hear a comment from your friends, from your superiors that really you are a civil servant, you do not really know what you are doing, and the work you are doing is not important and we want to do away with it, this kind of thing, I do not care how much you pay that person, eventually they will leave.

And, particularly if they are qualified, if they have expertise and if they want to do something good and you have the excellent civil servants who left, such as was presented here.

Senator **Mack**. Mr. Chappelle, do you want to respond to that?

Mr. **Chappelle**. I agree with everything that was said. I can remember back—in the spirit of full disclosure, I should mention that I also worked at HUD back in my earlier days, and I was there from 1975 to 1986. I worked in the single family area. I enjoyed my stay at HUD. But I can remember being called in to work on Washington's Birthday in 1981 because we had just received OMB's budget proposal, the new budget proposal, and it showed FHA funding in the single family area, starting at what it was then, and by 1984 showing a zero. I think that philosophy permeated through the whole leadership of HUD at the time.

I mean, we were told that programs were there because the bureaucrats needed those programs to keep their jobs, and that the Federal Government was out of touch with what was going on. So I think the attitude was a big part of the problem. But in addition to the attitude, which I think as you said before, Senator Mack, Jack Kemp is correcting. There is the reality of the fact that people who are making $30,000 to $40,000 a year in the Federal Government could leave tomorrow and make $70,000 or $80,000. You are going to lose the best people because of that. I mean, people have to raise a family, put kids through school, etc.

I think that reality has got to be addressed in some form. Otherwise, the attitude is great, but without something behind it it just will not materialize.

Senator **Graham**. In the opening statements there were several comments about the increasing role of OMB vis-a-vis HUD direction and management. I wonder if you could comment further on what impact did that assertion of OMB dominance have on things like the sense of mission of the Department?

Mr. **Chappelle**. I will be glad to start. As someone who was at HUD in the early 1980's, every policy directive that we would put out, after the Congress would pass legislation, we have to implement the regulations. We would, to the best of our ability, implement the regulations.

We will talk about FHA mortgage limits as a classic example. We used to—every year when you would change the limits, we would have to go through the procedure. Well, then they would go over to OMB and sit for months on end. Then they would come back and say, well, find another data source. We were using Federal Home Loan Bank Board data sources, which was the best in the industry, and they would come back and find another data source. They would always be looking to chop the program back, to always put the reins on the program.

That is just one example, but in every major policy directive that came out of FHA in the single family area, from my personal experience, and I am sure in the multifamily area, they had to bless it. And while my experience is not as great in the 1970's because I was a younger employee, I do not think it was anywhere near as strong as it was in the 1980's particularly after 1984.

Mr. Grady. If I may also answer that, Senator, in the multifamily area particularly where my experience is, OMB reviewed, had to review every one of the instructions that were put out. Very often a regulation would be prepared, go through the very, very complicated internal clearance system of the Department, and then had to be submitted to OMB before it was put out. And sometimes it would languish for weeks, if not months, and then would be sent back for corrections, and work had to be done through OMB.

In the matter of establishing policies, OMB had to review those and, with a Secretary who was not able to hold his own against OMB, would not even attempt to defend his department. The people who were actually the civil servants, the top policy makers, the top civil servants, would have a feeling of discouragement.

We also found in the 1980's a succession of assistant secretaries and FHA Commissioners, five or six during an 8-year period. In the previous administration the same assistant secretary-FHA Commissioner remained for the full 4 years. And whenever you had this shift in the top, there was a vacuum and OMB just stepped into it. And certainly, if not in fact, the perception was both by the people within the Department and certainly those of us dealing with the Department, that OMB was running the Department.

Senator Graham. One of the questions that I have—and we are going to have a hearing on OMB on Monday—is you have just described an agency that is very involved in the nuts and bolts of HUD. OMB was reviewing every regulation, every directive, and yet OMB seemed to miss the big picture of all of the inappropriate behavior, maybe even fraud and criminal behavior that was going on.

How do you explain that OMB could have been in the internals of the transmission but not seeing which way the vehicle was basically headed?

Mr. Grady. I really do not know. I would be very curious to hear their explanation, if you ask OMB that question.

Senator Graham. Maybe we will charge admission for Monday's hearing. [Laughter.]

And have all of those people come who have had that question hanging in their mind.

Mr. Koelemij. Senator, talking about OMB, of course the passage of the Gramm-Rudman proposal gave a, I don't know, a purpose to OMB, or another reason for OMB to apply what that Act tries to do in policy making, because it is tit for tat, or how are you going to pay for it, and that is the role that OMB has been playing.

I am a State director for an arm of the national organization Dan belongs to, and it is the Southeastern Association of HUD Management Agents, and we try to have one meeting a year where we try to get all of the HUD management agents together. So for the last 2 years we had it in Orlando because it is less travel for people in the State of Florida from north and south to come to Orlando or Tampa.

This time we had it in Jacksonville because the HUD office said, we have no travel money to come to Orlando and to properly staff your meeting and to make it worthwhile for us. So we did hold it in Jacksonville, and we had a very successful meeting and they brought all of their people.

But every time you talk about a program, it is OMB that is cutting back. This time in the proposed appropriations bill one thing—and it is in reverse—under certain programs like section 236, we pay excess rent to the Government, and the money was used by HUD to fund what they call the "flexible subsidy program" for projects that are in trouble.

The proposal today under the administration budget is to no longer have this money available for housing. They would go into the Treasury because they are going to do away with the FLEX program. So they take money away from us, but they do not always give it to us when it is needed to support the programs that are in force and effect.

Mr. Siflinger. I think I might say, Mr. Chairman, that I believe it is fair to say that the philosophy of OMB with regard to housing was that the Federal role and responsibility and budget authority should be significantly reduced.

One, as a matter of philosophy, the Federal Government does not belong in housing.

No. 2, it cannot carry out its mission.

That, I think, dominated OMB. It is a matter of fact and principle that if you do not put into place an evaluation and monitoring system, then your philosophy of it cannot do the job, and it will be a self-fulfilling philosophy. And if people are not watching and monitoring, then the abuses will occur, as they certainly did. There was no attention to monitoring and evaluation, and that is why it is so critical as we think about a role for HUD in the 1990's that we not lose sight of a very important evaluation and monitoring role as we go forward.

Mr. Chappelle. Mr. Chairman, the one thing I would like to add to that point about OMB is: The good news is that with the new Bush administration and Secretary Kemp and C. Austin Fitz at FHA, I think the relationship between OMB and FHA and HUD in general has gone back more into the appropriate role for OMB. They are there. They serve a management function. And I think they are not stepping over their bounds into the program areas like they did throughout the 1980's. So hopefully the problem has been abated and we will be able to move forward and let HUD do its housing business.

Senator **Graham**. Let me ask—excuse me, Connie. My time is up.

Senator **Mack**. I guess my reaction to the issue about OMB, which we will get into in greater detail on Monday I guess, is that in a sense OMB is kind of like a credit manager in a sales organization. You know, having been in a sales organization in the past with the enthusiasm to go out and do the things that people in sales want to do, you always get upset with the credit manager who makes you be a little bit more realistic about what you are getting into. So I am not going to be too critical at this point at OMB, even though I think that the message that really comes out of it is: Because of the imbalance in the relationship between OMB and HUD in the 1980's, OMB really was able to be much more aggressive than you would like for your credit manager to be from time to time.

There was—I think, John, you mentioned in your comments, at least it brought to my attention again the issue about the drop in numbers. I do not think that—let me pose this to you—I would assume from what you said that really a reduction in numbers in itself is not necessarily bad. I tie that in to the sense that the idea of privatization, if you will, which I am not sure is the best term to use with coinsurance, the idea of shifting some responsibilities to the private sector, the idea behind that again as we heard from the earlier panel in one way or the other, you are going to get a reduction in staff by shifting that responsibility.

The key was that the monitoring of the program did not take place, and that is where the problem came about. So I guess what I am saying to you is: It seems to me that there are opportunities in which we can see shifting of responsibilities where you might find a reduction in staff, but if that is to occur you have to make sure that you put in place the kinds of internal controls, and the kind of monitoring that needs to be done to make sure that those programs were being properly operated.

Mr. **Koelemij**. Well, Senator, I agree. And for me to answer that question would be really foolish if we have an expert like Brian Chappelle sitting on this panel who I think gave birth or designed the underwriting.

Mr. **Chappelle**. The single family program, not the coinsurance program.

Mr. **Koelemij**. Yes. I know that. The single family. And that is a part—and I think he should probably address that, really.

Mr. **Chappelle**. I kind of forgot the question, to be honest with you, Senator.

Senator **Mack**. Well, in essence I guess the question, or the statement was this: That we should not necessarily get hung up on the numbers of employees. We should be looking at what the Department is doing, and that——

Mr. **Chappelle**. Oh, monitoring.

Senator **Mack** [continuing]. One could make the argument that you can shift to the private sector certain responsibilities that could reduce staff requirements, but at the same time it enhances or increases the necessity for having qualified people who can carry out the monitoring that needs to be done.

Mr. CHAPPELLE. Monitoring. No question. Starting with the coinsurance program, the monitoring was there I feel because in 1986, MBA sent a letter to HUD recommending that you do some tighter monitoring. So the procedures were in place to identify problems.

What was not in place in 1986, and subsequently never, was the will to do anything about it. There were defaults. There were increasing defaults, and actions were not taken. When a trade association writes a letter to a federal agency asking for increased monitoring, I mean that is a relatively rare thing that happens. So I think that is part of the problem, that there was not the will to carry out the procedures.

Speaking from personal experience on the single family side, lenders feel they are monitored excessively; that FHA has three prongs where they do reviews on lenders. What we would like to see is the criteria used in our letter in 1986 loans in default and claims paid, that is objective, that is easy to see, and people are above or below the acceptable default line. You can make judgments accordingly. In the single family side, we would like to see a lender's default and claim rate be the primary criteria for lender performance.

What it is right now so often is—what it used to be; this was always a horror story that I heard—if you used red ink versus blue ink for your comments, you would receive a different rating from the HUD reviewers in field offices. At the time I worked at HUD and was embarrassed by that. That is why we want the criteria to be more objective so that the bottom line is the key. As the new FHA people are talking about, we are going to look at your profitability and how well you run your program, and as long as you give us good, quality product, we will let you do your business.

Our members welcome that. We want it to be objective. We want it to be tangible criteria—because when you get into subjective and judgmental views, then the lack of experience in the FHA staff which exists really surfaces. They really cannot exercise judgment. They look at the book and say, you exceeded the ratio by a tenth of a percent, and that is where you get into trouble.

That is why, the more objective the criteria, the better we feel it is.

Mr. GRADY. Senator, if I may just add on the point of view of coinsurance, I was one who felt that the program was flawed initially and would end up where it did in a complete disaster.

I think that, going back to the analogy which you made earlier about the sales manager and the credit manager, that program was equivalent to giving the various salesmen the authority to write orders forever, receive their commissions and their salaries, and the credit manager—and the shipments would be made of the product—and the credit manager only looked at it whenever the products were not paid, and by that time they were all gone and completely finished. It is only when the default occurs that they look.

There was no monitoring, no proper monitoring, and the commissions were paid. The fees were paid. The coinsurance made their profit at the front end.

Senator MACK. Let me follow through on that concept or that idea, because Mr. Siflinger I think you said or suggested that maybe we ought to delegate to the State and local entities as much as we possibly can. I think you also kind of indicated that at this point there is a pretty high level of expertise both at the State—and I am sure that is different from State to State and localities—but I guess my question is:

Do we run into the same potential problem of monitoring what is going on as we did say between coinsurance and delegating to State and local?

Mr. **Siflinger**. Well, MHFA, my agency, is a coinsured lender. We have issued mortgages in excess of $200 million under the coinsurance program, and there are a number of other State agencies that have the capacity I think to engage in such a program, and we did so I think with success.

But Dan's point is a good one. In any system of decentralization, you must have an evaluation component. Now technically HUD had an audit responsibility under the coinsurance program. They did not do it. They simply did not do it. There was such an overreaction to a philosophy of decentralization that common sense did not prevail, which I think led to the abuses.

So under any system of decentralization, there must be evaluation and monitoring by HUD.

Senator **Mack**. I might be getting us off the point here, but let me just—Mr. Grady, did your analysis of the coinsurance program and your feeling that it would not work, did it fail for the same reasons that you anticipated that it would fail for? Or did it fail for monitoring? That was a different issue?

Mr. **Grady**. No, I think I stated to the dismay of many of my colleagues that it would fail for exactly the reason that I was talking about, that you could not allow certain people who were driven only by the money that could be made at the front end and were promising and advertising the fact that they could get mortgage insurance and mortgages which clearly would not have been acceptable by a full insurance program, which were not within the program of FHA, but they could do this because there was not any monitoring and the thing was done. The money was disbursed before anybody looked at what had happened.

Mr. **Siflinger**. I think my point is that an effective evaluation and monitoring system would have picked up those flaws very quickly and would have corrected the problems in the program.

Mr. **Chappelle**. The only thing I would add to both gentlemen's statements is that the HUD staff knew there were problems even far before 1986 when MBA wrote their letter, because I was at HUD back then and they knew there were problems. It really goes back to the will of the people to do something about it, because the staff knew it. They were concerned about certain projects, because I had heard about them when I was still in the single family area.

So it really starts from the top. That is where the problems started from.

Senator **Mack**. Thank you.

Senator **Graham**. I think this is a very important line of questions that Senator Mack has been pursuing. We had on the first panel Mr. Sevier who in his region presided over, over his objection, the grant of a coinsurance loan that was three or four times what his professional staff felt was appropriate. The program was so structured that the central office of HUD took the position that, once having delegated underwriting to a coinsurer, that it had no ability to override the judgment of that coinsurer even when they had overwhelming evidence that it was a very noneconomic decision that was about to be implemented.

So I think the program suffered from some very basic structural defects which were then compounded by the inappropriate monitoring of those. And when such a gross example as the Colonial case surfaced, no one was sounding alarms that we are in deep trouble here and we need to figure out a method of retreat. End of editorialization.

Mr. Grady, in your comments you touched on the fact of consistency of administration of the HUD programs among various field offices, and you do business in how many different HUD regions?

Mr. **Grady**. In about four different HUD regions.

Senator **Graham**. Could you elaborate on what types of inconsistencies in administration of programs you have experienced from region to region, and how serious a problem is that, and if you think it is a problem that warrants some efforts at remediation, what steps would you recommend?

Mr. **Grady**. Well, what we found was that if you had a regional administrator who was a very strong leader and strong person, there would be certain rules that were issued for that particular region. I remember a time in region 9 where handbooks were actually issued which had a "SF" number in front of the number of the handbood just to represent the San Francisco region, and which were not applicable and put a theory of, for instance, regulating management fees which did not exist anywhere else.

I found out in another region where, for instance more recently, the definition and the implementation of "preferences" and "qualification" for admission to a section 8 program are totally different than what is the advice and actually the orders put out by the central headquarters and the Office of Housing to qualify people. And there is a divergence of opinion from that region and from all other regions.

When we in our office bring our managers together, and we do this about three times a year for training of our managers in the various projects, we try to run through what we expect of them. Then we usually have to say, this, except in region so-and-so, or region so-and-so, where you have a different interpretation either on how to calculate income, for instance for section 8 qualification, different admission policies, or different reporting policies.

I think that this has been experienced by everybody who works in different regions, and sometimes even in different field offices within the same region, because there is not a constant monitoring. This observation has been exacerbated since the reorganizations where the Assistant Secretaries had no direct control and could not actually see that the regulations which they implemented and the programs which they supervise was delivered in any particular fashion by the regions.

Specifically in answer to your question, I think, Mr. Chairman, that this occurred in the field of admission to projects, in the field of determining income qualifications, in management fees, in reporting, and currently there is a different interpretation just in the submission of claims for damages and vacancy payments from region to region.

And those are the daily things that we deal with all the time.

Senator GRAHAM. Any other comments on that issue of diversity among field offices or regions?

Mr. CHAPPELLE. I will just add to that and make it brief that that is probably the number one issue for lenders in the single family area particularly who deal with 5, 10, 20, 30, up to 81 field offices. I mean, that is their No. 1 frustration in dealing with the offices.

To the credit of the State of Florida, what they have done down there with HUD, they have four field offices and they do meet regularly and they do exchange things to try and get some consistency. So I think the problems in the State of Florida are probably as minimal as they are in any part of the country, but it is an ongoing problem because different people set different arbitrary requirements, and it makes it very difficult to comply with them. Then you get rated down for different things. So it is very frustrating on a national basis.

Senator GRAHAM. Any other comments?

Mr. KOELEMIJ. Senator, I agree with Brian that it is probably also the weather in Florida that keeps the good people in the offices of HUD. [Laughter.]

Mr. SIFLINGER. I will just confirm, Mr. Chairman, that we have heard from many of the States about the same issue of different approaches in various regions.

Senator GRAHAM. Gentlemen, we appreciate very much your participation today. Thank you.

Mr. CHAPPELLE. thank you.

Mr. GRADY. Thank you.

Senator GRAHAM. Our third panel will have a single participant, Mr. Dwight Ink, who is currently president of the Institute for Public Administration in New York

Good afternoon, Mr. Ink. We appreciate your great assistance to this subcommittee and will be pleased to hear your opening remarks.

STATEMENT OF DWIGHT INK, PRESIDENT, INSTITUTE OF PUBLIC ADMINISTRATION, NEW YORK, NY

Mr. INK. Thank you, Mr. Chairman.

I found the previous panels very instructive and very interesting. I commend you on having a very good variety of perspectives brought here today.

Senator GRAHAM. Mr. Ink, if I could use that statement to compliment our staff which has done, I think, an excellent service in identifying issues that are not necessarily the most obvious such as the ones we have just been talking about in bringing to bear both within the agency and from external individuals, and now in your case a distinguished scholarly oversight of public administration, a good analysis and recommendation. I want to publicly thank them.

Mr. INK. So often congressional committees get lost in the details of a problem and concentrate on the symptoms of a specific problem without really getting to the roots of the problem. Therefore, the solution oftentimes is a very temporary one, and the result is a new form of the same kind of problem emerging later on.

I understand that there is interest in reviewing some of the concepts that were originally built into HUD when it was first established, and which have been lost over the years.

I would like to first say that I share the view of those who applaud the work of Mr. Kemp, and I would say that he illustrates the importance of the leadership of a department. I also think the Department was very fortunate in having Bob Weaver as the first Secretary. Under both of these Secretaries, there was an enthusiasm, there was an attractiveness for people to serve in the public service, a sense of mission, and an emphasis on integrity.

The most important element in any organization is people. In my written testimony, which I will submit for the record, I decry what I regard as a modern spoils' system which is a part of our appointment process for political positions that we tolerate in the Government. Use of the appointing system for political appointments as a patronage arm of the winning political campaign I think is a serious mistake.

There are all kinds of capable people in both the Democratic and Republican Parties that an incoming President can draw upon who are compatible with his political viewpoint, who are supportive of his political policies without having to resort to what I refer to as basically a spoils' system which sometimes produces competent political people, and sometimes very incompetent political people. In the latter case the damage to a department can be enormous.

I talk in my statement about the career/political interface, and the importance of that. Again, Kemp and Weaver know the importance of that kind of interface and are able to draw upon political and career people as a team. The political and the career people each have an important role and neither can be effective without the other.

In my written testimony I talk about prevention and investigation. Over the years, there has been a declining interest and support in the capacity of managing HUD and a greater reliance upon the external oversight and investigation, a shift which I think has been counterproductive.

It seems to me that HUD has had some very good inspector generals, as for example, Mr. Dempsey and Mr. Adams. But there was a total failure of the departmental leadership to either respond to the red flags that were waving, flags which most people knew about. Although they may not have known how serious the problems were, they certainly knew there were many problems. It was their inability or failure to manage the Department in the first place that has really led primarily to the recent disaster.

One of the most serious trends, in my view, has been the gradual deemphasizing of the HUD early warning systems. You heard this morning many comments about the importance of early warning systems. I will list several.

In my written testimony, I talk about the program monitoring that was first established in the Department. It was the first domestic department to require a preaudit before funds went to new recipients. Early audits were made within weeks after funds went to new recipients.

Joint reviews between the assistant secretary for administration and the program assistant secretary were scheduled to look at the substance as well as the financial characteristics of the new programs shortly after they went into operation. They were designed to pick up vulnerabilities early in the operation of a program, when one could see how they were actually operating, not just how they were planned to operate.

HUD is the only Department that had a field operation which included local expediters that were so effective they became unpopular with certain members in the House who felt they were competing with their ability to solve government problems, and their funding was deleted.

My statement also referred to the regional management reviews, the Assistant Secretary visits, and a series of early warning and preventive measures that were built into the Department that began to gradually fade away about 1970.

The lack of careful design of new and modified programs also has been a very serious problem. One of the results of that is the confusion of roles, including roles of the regional offices, roles of the assistant secretaries, role of the field offices. Delegations of authority have not been clear. If you do not know who is responsible for what, there is no accountability and you are inviting serious problems.

In my written testimony I describe the role of the special assistants, under both Republican and Democratic administrations as much too powerful, especially special assistants in the Office of the Secretary.

We have heard some excellent comments this morning concerning employee development. The attraction and the retention of capable people is really the foundation of any effective organization, and that has declined in HUD. The loss of good people, the loss of talent is of course something that is irreplaceable in a department. It has to be replaced.

When the Department was first established, great emphasis was placed on how programs were designed. That included the guidelines, the roles, and the processes that were flow-charted. Analysis of staffing requirements took place, and the need for training was included.

Initially there was followup. The decline in followup of problems managers have detected in new programs we have talked about, but there has also been a decline in terms of followup of the IG and GAO reports. In other words, when problems were flagged by different groups there has not been either the will or the capacity to react quickly.

Reference was made to OMB. I am one of the few, and maybe the only one, who has served at a policy level in both HUD and OMB. I do not know whether time will permit me to testify on Monday, but let me say one thing now. The budget part of OMB has totally overshadowed the management part of OMB in recent years, and what is left of the management side—which is not very much—is concentrated on detailed process and regulation. For example, this detailed review, regulation by regulation, by OMB is absolutely the wrong way to go about dealing with excessive regulations in our

Federal Government. It is slow and counterproductive, and ought to be replaced as a part of a basic OMB overhaul.

Oversight: I think our oversight has begun to lose its way in the Federal Government. HUD illustrates the value of an independent investigative capacity by the inspector general, but it also illustrates the folly of relying so heavily upon that kind of external review that the internal capacity of oversight erodes. After all, it is the manager who has the basic responsibility for oversight of those programs, and it is the manager, not the external review agencies, that can take quick, corrective action.

Let me say three things in conclusion. First, I would stress the importance of prevention achieved in part through careful program design.

Second, I would stress the importance of early warning systems to detect problems quickly when they begin to emerge.

Third, I would stress the capacity to take immediate corrective action, generally beginning within hours, not days, weeks, or months, but within hours after the problems begin to emerge.

I would hope that Mr. Kemp with his leadership, having dealt well and dealt decisively with some of the financial management problems of the Department, can now move forward and deal with other areas of Department rebuilding such as the structure, such as clarification of roles, and especially human resource development.

Thank you, Mr. Chairman.

[The prepared statement of Dwight Ink follows:]

Statement of

Dwight Ink, President

Institute of Public Administration

for the

HUD Investigation Subcommittee
Committe on Banking, Housing and Urban Affairs
United States Senate
Honorable Bob Graham, Subcommittee Chairman

On Staffing and Resurce Capacity

April 20, 1990

Testimony of Dwight Ink
President, Institute of Public Administration
for the
HUD Investigation Subcommittee
April 20, 1990

Mr. Chairman and Members of the Committee:

I am pleased to have the opportunity to appear before this Committee today as it further examines the circumstances which led to the HUD scandals and considers steps needed to ensure better performance in the future. A number of people believe that over the years HUD has lost a number of features originally incorporated in the Department that would have made a major difference, although I am sure those features needed to be updated and modified to fit the ever changing conditions any department faces. It is my understanding, Mr. Chairman, that you would like me to review some of the concepts originally built into the Department that might have reduced vulnerability to the recent problems, had they been retained.

Before proceeding, however, I should like to count myself among the large number of people who applaud Secretary Kemp's strong and vigorous leadership in HUD. As you are well aware, overnight he established an entirely different tone in the Department, and an entirely different environment. It is a tone which emphasizes integrity in one's work and a positive environment in which to perform that work. In a period of painfully limited resources, he has generated enthusiasm and a sense of purpose among employees who had endured weak leadership that was largely negative.

HUD was also fortunate in having an excellent initial secretary when the Department was first formed, Bob Weaver. His firm belief in integrity and his long experience and personal knowledge in the areas for which HUD was to have responsibility were important reasons HUD was a successful department in its early days.

I will provide comments on departmental management I hope will be relevant to your inquiry. Some relate to HUD specifically, several reflect a general de-emphasis of management in our national government.

People are the Foundation.

Patronage. The example of Mr. Weaver, as well as the contrast between Mr. Kemp and his predecessor, illustrates my strong opinion that the most important element in an organization is people. Intellectually, we all know this, but as a government we very often do not practice what we all proclaim in our rhetoric.

In my view, the people problem begins with our flawed system for political appointments. I have had a rather high regard for most White House directors of personnel, but the whole appointment machinery is pressured to operate like a patronage arm of the winning campaign machine. This is a bipartisan failure in which virtually every advance person, and every person who donated heavily, is felt to have earned a government job.

Some appointees are well qualified. Others may have demonstrated campaign skills but are dismally unqualified for helping to run a department. We tolerate an appointing arrangement that is largely a patronage system, and I have always looked upon patronage as a form of corruption which generally leads to mismanagement and more serious forms of corruption.

Clearly, presidents must have departmental leadership that is loyal and politically compatible in order to address the issues on which the President has campaigned for the office. I do not regard this as patronage, but rather a legitimate means whereby an elected leader can strive to carry out the campaign pledges made to the voters. Patronage, on the other hand, is a spoils system which confuses who owns what. It says that government positions belong to the winner, whereas they really belong to the public.

The public is entitled to have programs they support with their tax dollars in the hands of qualified people, and both the Republican and

Democratic parties have within their ranks many capable people who are loyal to an incoming President, without having to resort to patronage which places contribution to an election above contribution to the public good. These positions should not be for sale or used for on-the-job training.

Unqualified political appointees do enormous damage to a department by opening the way to mismanagement and abuse even if they themselves never engage in corrupt practices. HUD has suffered greatly from a mix of competent and incompetent appointments.

Career-Political Interface. Another result of political patronage is that it tends to accentuate a common problem of distrust of the career service. It is particularly difficult for those entering through the patronage route to understand how anyone who served under a prior administration could be fully trusted to work on behalf of the new team. Further, when the new appointees are inexperienced, they seldom realize that the effectiveness of the political leadership in attaining its program objectives will depend heavily upon the extent to which they have been able to enlist the support and understanding of a qualified career service.

One of the strengths of Weaver and Kemp, one a Democrat and the other a Republican, is that they share a high regard for the career men and women, and look upon both the political and career officials as essential to success of the Department and, therefore, integral parts of the same team. This is critical for departmental management. As an agency head, for example, I refused to convene any meeting exclusively for either political or career personnel. I believed strongly that we could far better develop proposed policies for the President and Congress, and could much more effectively implement Presidential directives when the political and career leadership joined forces. Each has an important role, and neither can be effective without the other.

Political Overload. A development which greatly aggravates the problem of poor political appointments, including HUD, is the unfortunate fact that there are far too many political appointees, a problem that was well described by the Volcker Commission. Most Western European nations long ago concluded they needed very few political appointees for the effective running of the government. So has Japan. Excess political appointments is a governmentwide deficiency we have to correct.

Prevention and Investigation.

In view of the crisis that developed at HUD, one might easily conclude that the Department needed a more vigorous Inspector General and more indepth investigations. I suspect there were some instances which in retrospect might have been pursued more vigorously by the IG and GAO. I would assert, however, that HUD has had the benefit of two very able Inspector Generals in Messrs Dempsey and Adams, and that they performed very well. It was the total failure of HUD leadership to either listen to the IG and GAO warnings or, even more important, manage the department in the first place, that led to the recent disaster.

I believe that one source of the HUD problems had its roots in the early 1970's when the department began to shift emphasis from prevention to investigation. More effective investigation would have been a positive move if it had not been at the expense of prevention. One of the most serious consequences was a gradual de-emphasizing of early warning systems which were so important during the early days of the Department. I am told that many were either abandoned or given only lip service in later years.

Early Warning Systems. Several of these precautionary measures might be of interest to the Committee.

1. **Program Monitoring.** Monitoring of program activities was a continuous process built into the design of each program. It was regarded a basic element of each manager as described later under the discussion on oversight.

2. **Preaudit.** HUD was the first domestic department to adopt a policy of making a "quick and dirty" preaudit of the capacity of new community funding recipients to prevent diversion of funds before any funds were permitted to flow. On the one hand, our policy was to provide grant recipients with considerable flexibility in many ways because we wanted the funds to assist in the capacity building of local

governments and we knew that rigid federal procedures often undermined that capacity building. On the other hand, we were adamant that recipients have the capacity to "put a lock on the cashbox", since diversion of funds destroys the confidence of Congress and the public in any department and its programs.

3. **Early audit.** Within several weeks after funds began to flow to new recipients, and before large amounts were involved, we made another audit. These were very limited audits which focused, as did the preaudits, on the control of funds. But here we could see how those controls were actually working, rather than simply how they were intended to work.

Several weeks after the Model Cities program (a favorite of President Johnson) was launched and the initial funds released, these early audits showed some alarming vulnerabilities. These all reached my desk in a group early one afternoon and within two hours I ordered all funds to about half of the recipient cities suspended until their internal control of funds had been made acceptable. This somewhat dramatic action caught the attention of everyone in the program and sent a clear signal that the Department was very serious about the protection of funds.

4. **Joint Reviews.** When major new program initiatives were initiated, program management reviews were generally undertaken jointly by the program assistant secretary and the

assistant secretary for administration. Again, this was done within a few weeks after funds began to flow. When a new public housing program was implemented in the late 1960's, for example, an early joint review revealed a series of potential vulnerabilities. Quick corrective action was taken, much of it within a few days of discovery and all of it before funds were diverted or misused. I recall one finding was the need for a larger staffing effort devoted to program monitoring.

5. **Metropolitan Expediter.** Expediters with no program authority, and no funds to dispense, were sent out to various communities by regional administrators on a pilot basis. It was their task to listen to problems of city and neighborhood recipients of HUD funds and facilitate the resolution of legitimate complaints.

The pilot trials exceeded our expectations, and the expediters soon became popular emissaries that gained considerable community praise. They were too popular, however, and several House members saw them as competing with their Congressional offices as vehicles for solving constituent problems. As a result, their funds were deleted by an appropriations rider.

6. **Regional Management Reviews.** Periodically, the Deputy Assistant Administrator for Administration and the Department's top management expert would visit a regional

office for about three days for an informal review of its operations. Their focus was on the capacity of the regional office to implement programs quickly and responsibly, including the meshing of program and administrative management performance. Perceived vulnerabilities were reviewed with the regional administrator and his or her top staff. This two person team did not leave the region without corrective action having been decided upon, at least in general terms. Major problems were reported to the Secretary.

7. **Assistant Secretary Visits.** The Assistant Secretary for Administration visited each regional office about once every year, visits which always included an area office as well. The agenda varied, except that it always included (a) a visit through the offices to personally meet each employee, (b) a meeting with all employees assembled to discuss departmental goals and hear complaints and suggestions, (c) a special follow up review of all major audit, GAO, or internal management findings, and (d) a management discussion with the top staff. Major emphasis during these visits was placed on the role of the manager, including the manager's basic responsibility for employee development and the manager's oversight responsibility for all activities he or she managed.

All of these reviews were done with very few procedures or regulations. Numbers three, six and seven had none. Emphasis was on prevention of problems to the extent possible and the early detection of emerging problems before they became serious. When this approach began to be replaced with a heavy reliance on investigation by external oversight units, the Department lost much of its capacity to avoid abuse or to take immediate corrective action when lapses did occur. This trend has contributed significantly, in my view, to the later scandals and erosion of public confidence.

Decline of Departmental Management.

Until the arrival of Kemp, Departmental management had increasingly taken a back seat, thus virtually guaranteeing eventual scandal of major proportions. I understand that the list of negative consequences is long. I will list only six:

1. Roles. The weakening of management in HUD permitted confusion to develop with respect to the roles of both headquarters and field organizations. I will mention two in particular.

The role of special assistants in the Office of the Secretary became much too powerful in recent years. Too often these appointments went to unqualified people who saw the HUD programs through politically tinted glasses and who apparently took advantage of their proximity to the Secretary to influence flows of information and award of grants. This problem was accentuated by the lack of public accountability of special assistants.

A second problem of role confusion, that of regional offices, began in the early 1970's. Regional offices were originally given key roles for several reasons. First, there was a strong desire to decentralize operations out of Washington, both because these offices were closer to the communities HUD served and better understood their problems, and because Washington could not give proper attention to its policy and program oversight roles when it was bogged down in operational detail. Second, regional offices were both free of the somewhat unreal Washington environment, and they were not regarded as quite as susceptible to domination by local political factors as the smaller local HUD offices located in dozens of cities across the nation. Third, local offices could not be staffed with the full complement of management support that could be provided in each of the ten regional offices.

Finally, in the organizing of HUD great attention was paid to addressing the community as a whole in the belief that major urban problems involved issues that were generally interrelated. Addressing these complex issues could be done far better by properly staffed regional offices than by local offices which lacked the range of expertise to address the diverse problems communities faced that related to the variety of programs then assigned to HUD.

2. Human Resources. When HUD came into being, it was able to attract the very best graduates from America's best universities. In part this was because it was a new department with a mission that had high visibility in those days. I believe that another reason this great attraction continued for a few years was that HUD then provided an exciting environment in which to work. Both factors also contributed to HUD's initial ability to retain good people.

Great emphasis was placed on employee development. A major training effort was developed by the first Personnel Director, Arthur Tackman, an unusually creative and able man. (Unfortunately, Mr. Tackman later resigned in protest of the White House interference with the operation of the merit system as Watergate approached.) Formal training was regarded as a vital part of employee development, but training in the work environment was regarded as even more important, an area in which we never achieved the success we desired.

It has been my impression that as the newness of the Department wore off, and as the politicizing of the agency gradually increased, the ability of HUD to recruit and retain outstanding people has eroded. Some very dedicated and able people have continued to work at HUD and contribute to its missions, but I understand that there has also been considerable loss of good talent. This is a very serious problem not quickly remedied.

3. Management Design. Originally, the administrative staff in the offices of both the program assistant secretaries and the assistant secretary for administration were fully involved from the outset in the design of new or modified programs. Obviously, this is the point at which they can have the greatest impact.

The focus of the administrative staff was on how to help the program people design new programs to achieve their objectives in ways which minimized risk or abuse. Their suggestions were not always greeted with enthusiasm, but the disagreements were much less than occurs when the administrative people come into the process after the design is largely completed and program people then see their input as unwarranted intervention likely to significantly delay action. At that stage, management concerns are often brushed aside.

It was the role of the assistant secretary for administration to ensure that program design developed by the program organizations included necessary guidelines, that roles were clearly defined in writing, that the process was flow charted, that analysis of staffing requirements had taken place, and that training was provided.

HUD has always had difficulties matching staffing resources with program requirements. Community activities are quite complex and the Congressional and White HOuse expectations have seldom recognized how these translate into HUD staffing needs. Excessive procedures have often added to this problem. Without a strong analytic base, and without leadership that will explain to an OMB that there is a point beyond which no organization can do more with less, programs cannot be managed well.

4. Follow up. After glancing through the IG and GAO reports of the 1980's, one is struck at the lack of meaningful response to the weaknesses these reports contained. Admittedly, they did not really plumb the depths of scandal until rather recently. But the warnings were nonetheless numerous and quite serious. In fact, in their totality I believe most good managers would have regarded them as an indictment of departmental leadership. Any leadership that received these warnings and failed to react with an immediate Secretary driven cleanup campaign should have been replaced.

Where were the Secretary and the Undersecretary when these warnings were given? Where was the Assistant Secretary for Administration who should have been beating the drums for an emergency clean up? Where were the Congress and OMB? It would seem that many contributed to the failure to address the HUD problems promptly, but the basic responsibility for failure must rest squarely with the Departmental political leadership which appears to have abdicated its sense of stewardship for the Department and its programs.

5. **Oversight.** I would argue that we are losing our way with respect to oversight in government, a circumstance which may eventually lead to grave consequences. HUD illustrates the value of an independent investigative capacity as represented by the IG. It also illustrates the folly of relying so heavily on an IG operation to provide honest and effective departmental operation while ignoring the oversight role of the rest of the department and permitting departmental managerial capacity to erode.

The basic responsibility for oversight does not lie with the IG, the GAO, or the Congress, important as their roles are. Oversight is a fundamental element of management and is a basic responsibility of the manager. No manager can possibly succeed if that manager feels no responsibility for monitoring his or her programs. It is the manager who best understands the program. It is the manager who is in by far the best position to sense early indications of problems before they become serious. It is the manager rather than external oversight bodies that is in a position to direct immediate corrective action. Once managers begin to feel that oversight is someone else's responsibility, and once their capacity for oversight is shifted to external entities, we are headed for far more mismanagement, misuse of funds, and scandal.

Neither Congress nor OMB seem to fully realize that Inspector Generals, no matter how able, do not manage departments. They have a vital role to play, but they have been expected to carry a broad burden for departmental management they cannot - and should not - be expected to carry. Effective external and internal oversight are both essential.

One of many problems of current approaches to oversight is that the preoccupation with auditing and investigating places undue emphasis on extensive procedures and regulations at the expense of hiring and developing good managers.

6. **Assistant Secretary for Administration.** Just as the assistant secretary for administration role graduated in the late 1960's from the chief clerk concept to one of a focal point for departmentwide management leadership on behalf of the Secretary, the position then began to be politicized in most departments. As a result continuity was lost, and its effectiveness undermined. An experienced assistant secretary for administration who knows the department and its programs is of invaluable assistance to incoming political leadership. In addition, the responsibility for management leadership has been fragmented among several offices, increasing the difficulty in recruiting strong managerial leadership and, by definition, making it almost impossible to exercise such leadership. There has not been such a focal point for management in HUD for years.

The position of assistant secretary in most departments, including HUD, has reverted in practice to some of the characteristics of the earlier chief clerk role, but with a political coloration. When able people are appointed to these positions, as they sometimes are, they are nonetheless often handicapped by the political baggage they carry. Too often they lack an understanding of the demanding elements of public accountability and public service ethics that they should help a cabinet member instill throughout the department. At times they also have only limited experience, severely weakening their role. Finally, these assistant secretaries, unfortunately with unintentional encouragement from OMB, have become preoccupied with overly proceduralized administrative management at the expense of program management.

CONCLUSION

Mr. Chairman, I have tried to highlight some of the factors that have weakened HUD's managerial capacity since it was first organized. I am sure there are other important factors of which I am unaware. I suspect that I have also failed to recognize the valiant efforts of many career people in HUD who have labored diligently despite the publicized shortcomings of the Department. Somehow, these people should be spared the taint of scandal and be given recognition for their continued public service. I believe Secretary Kemp has tried to do this, but there needs to be external recognition as well.

I would hope that the Department will pursue those basic elements of rebuilding the Department that may still remain. Addressing the financial management problems was a critical and urgent step, but the rebuilding also involves reviewing the departmental structure, clarifying roles, establishing program (not just fiscal) accountability, renewing the priority and the vitality of human resources development, and recreating a focal point for the departmentwide management leadership it so desperately needs.

HUD's problems are an extreme example of the governmentwide lessening of attention to effective management. In recent years there has been a steady decline in the extent to which the work environment for federal managers has facilitated productivity, accountability, and prevention of mismanagement and corruption. This trend must be reversed if we are to avoid other HUD like debacles.

Senator **Graham**. Thank you very much, Mr. Ink. We appreciate your comments and the very thoughtful paper which you have presented us which will be included in full in the committee report.

I would like to ask some questions on the role of Congress in the various managerial and administrative areas that you have outlined. You have made some comments about the quality of political appointees, some of whom were subject to Senate confirmation. Do you have any thoughts as to how the Senate can improve its confirmation responsibilities in order to be more discrete in ferreting out the competent from the less than competent?

And second, in terms of personnel policy setting standards for those appointees not subject to confirmation?

Mr. **Ink**. I think the Senate confirmation process could and should give greater weight, particularly at the sub-Cabinet level, to the experience and competence of those being confirmed.

I think that the confirmation hearings sometimes get carried away with the political issues. The President ought to have the opportunity to appoint people whose political views are consistent with his, even though they may be unpopular with the Congress. I do not think a President has the right, however, to appoint incompetent people whose salaries are going to be paid by the taxpayers, and who will have responsibility for operating large programs.

The public has the right to qualified people at both the political and the nonpolitical levels.

Now with respect to personnel, I think that the emphasis of too many congressional hearings gets lost in the trees. The specific details of a particular contract, for example, are dealt with at great length but rarely, Mr. Chairman, rarely do the committee deal with the kinds of basic management issues that this hearing is striving to deal with. Consequently we see a lot of bandaids—generally more regulations, generally more checks and balances—to deal with that particular problem, and we solve a little problem of yesterday. This results in building more processes and regulations which make more likely either (1) less ability to act in future; or (2) so much process and regulations that future people end-run those processes feeling that the bureaucratic system is so complex that it will not work. You have people coming in who want to act, find they cannot act under the system, so they end-run it. When people get used to end-running systems, then that leads to widespread abuse and corruption.

Senator **Graham**. It has been suggested that the position of Assistant Secretary for Administration should be designated as a career position. Do you have any comments on that?

Mr. **Ink**. I think the Assistant Secretary for Administration should be a professional manager. I do not think they should have to have come from inside government, although I think that probably would be the case in most instances for continuity and because it is very difficult for someone coming in from outside government to grasp the complexities of governmental systems, particularly the governmental budgeting process. But I believe the primary emphasis should be on professional experience and professionalism, and that is not done today. We have a great mixture of competent and incompetent assistant secretaries for administration.

Senator **Graham**. I was interested in your comment about early warning systems. At the first meeting of this subcommittee, Mr. Downs of the Brookings Institute mentioned the need for program evaluation as a part of developing a new program.

How would you incorporate that evaluation process into an early warning system? Or maybe you could comment—you indicated that prior to 1970 there seemed to be an effectively functioning early warning system. Could you elaborate as to what existed prior to 1970, and what has happened since then?

Mr. **Ink**. I mentioned in the written testimony that when the Model Cities' Program got underway we did make a preaudit of each of those recipients. In a number of instances, we delayed giving funds to those recipients until they had provided stronger internal controls for the protection of funds.

Then within several weeks after funds began to flow, we had another audit, a very quick audit, and found that in a number of instances there were serious vulnerabilities and in one afternoon, I suspended funds to about half of the Model Cities around the country who were in that first group.

Now, Mr. Chairman, that caught the attention of people. That was monitoring which had some force behind it, and people across the country took notice and really strengthened their internal controls.

A new Public Housing Program later got underway and there was a joint review between the Assistant Secretary for Administration and the Secretary in charge of public housing within a few weeks after that program became operational. There were, I have to tell you, far more vulnerabilities that were emerging than we ever expected, even though we thought we were careful in the design of that program.

The Assistant Secretary in charge of housing, public housing, then quickly made a number of significant revisions in the design of that program. Consequently, neither one of these programs had any substantial scandals as they went forward. But had that not been done, I think both of those programs would have been cause for a great deal of criticism, and probably very substantial abuse and scandal.

Senator **Graham**. Mr. Ink, my time is up for this round and also I am afraid my time is up for this hearing. Senator Mack has agreed to preside.

Senator **Mack** [presiding 12:52 p.m.]. I really only have one more question that I would want to raise, but if you have to leave you go right ahead.

I really just want to follow up on 1970 because it is interesting that in the last several days there has been an indication that 1970, approximately at that time, is when we saw a deterioration in, if you will, the checks and balances in the system.

Mr. **Ink**. Yes.

Senator **Mack**. And that over a period of time there has been a gradual reduction in monitoring, in preaudits and follow-up audits——

Mr. **Ink**. That is correct.

Senator **Mack**. What brought that about? What occurred in that period of time? And again I am not trying to move away from the idea that there were not any problems that did not develop new in 1980, but there seems to be a gradual reduction in this monitoring and making sure that programs work and for their being effective.

Mr. **Ink**. Well, that is correct. That is when it began, although much of the problem got worse later on. There are a couple of things that I would observe. First of all, there was a noticeable shift in 1970 from the early prevention and monitoring to oversight, external oversight.

Senator **Mack**. Now what do you mean by "external oversight" there?

Mr. **Ink**. I would say more reliance upon investigation as to what has gone wrong, and less on the prevention. The FHA 236 Program, for example, got into trouble in 1970, I believe it was. I was no longer Assistant Secretary, but I observed this at OMB.

I talked to Romney when we learned that this program had gotten underway with heavy decentralization, and found that there had been virtually no careful design of that new program that had taken place. The roles of the regional offices and the field offices had not been clearly delineated. There was virtually no training of people to handle a new program.

I talked to Mr. Romney and I said, why did you move in that direction when we could have been of some help to you in decentralizing? He said, well, we did check with so-and-so in the OMB, but the person he identified was in the budget part of OMB. So you had two things wrong:

One, the management part of OMB was not brought into play.

Second, within the Department itself you had the beginning of a loss of attention to management design of program including inclusion of early warning systems.

Senator **Mack**. It sounded like you were saying there that back at that particular point that the decisions were again driven by budget requirements.

Mr. **Ink**. Well, in that case the decision was not so much budget requirements, but the budget part of OMB ignoring management. It was really I think a laudable desire by the Secretary to increase the amount of housing, and to increase productivity. And that was fine, except the productivity did not have built into it a quality element. Productivity is really not productivity if the quality element is absent. That was not basically a budget problem, but rather the early stages of erosion of HUD managment.

Senator **Mack**. There is I guess maybe one more question that does come to mind, and it has to do maybe with—I use the term "oversight," or I thought of the term "oversight" from the perspective of what the Congress does with oversight.

In some of their earlier hearings, we are really trying to determine where the system broke down. I mean, you can look internally at HUD and determine that the internal controls, the monitoring systems, the auditing process in fact was not being used, but also what came out was that apparently the Congress did not follow up on its oversight responsibilities. For example, the FMFEA reporting process pretty much indicated to us that there were problems that had developed, and some of those problems were restated year after year after year, and nothing was done.

The Congress did not respond in a way either. I would be curious as to again should we be expecting—should Congress be expecting more out of OMB in the sense of the oversight necessary on those reports? But at the same time I do not want to give the impression that we did not have any responsibilities. Should we have taken more responsibility, too, is part of the question?

Mr. INK. Certainly the Congress should expect more out of OMB and, yes, it should expect more from itself. I think the early trends of decline back in the early 1970's, however, was not something that Congress would likely have picked up on.

Later on there were so many red flags waving through the years that Congress certainly should have recognized deficient management and taken some action, but not in the early stages. OMB had difficulties because of the dominance of the budget. You have found in recent years, in the 1980's, that the budget part of OMB was pretty comfortable with the way things were going in HUD, because the demand for adequate staff and the demand for program funds was not coming out of HUD.

And as I said, the management part of OMB was overshadowed and pretty much put aside and relegated to dealing with detailed regulations and procedures, rather than basic management.

When I talk about "external oversight," what I am really doing is distinguishing between what I regard as the basic internal oversight, which is the responsibility of the managers, and the Department officials, and on the other hand the external oversight of the Inspector General, OMB, GAO, and the Congress.

Now this latter external oversight is very important, but no amount of that external oversight can compensate for a lack of managerial capability and a lack of oversight by the program managers.

Senator MACK. And what I hear you saying is that really over a period of time that a greater and greater reliance occurred on that second oversight, as opposed to the oversight responsibilities of a manager.

Mr. INK. That is absolutely correct. I do not argue that the external oversight should be weakened. I think that needed to be strengthened. What I am arguing is that there was an overreliance on it which led to a failure to recognize that the basic responsibility must remain with the program managers and the leadership of departments and agencies.

Senator MACK. Well, again, thank you for your testimony, Mr. Ink, and for your responses to our questions.

That concludes today's hearing.

[Whereupon, at 12:55 p.m., the hearing was adjourned.]

WWH

May 15, 1990

The Honorable Bob Graham
United States Senate
Washington, DC 20510-0903

RE: Adams Plaza
FHA Project #063-43046

Dear Senator Graham:

Thank you for the opportunity to present to the Senate Banking, Housing and Urban Affairs Committee the history of the Adams Plaza application for mortgage insurance under the Section 232 Board & Care Program. The processing of our application by the the U.S. Department of Housing & Urban Development (HUD) is a prime example of the problems associated with working with HUD. These problems lead to the apparently widespread abuses which have been discovered.

The Adams Plaza application for project mortgage insurance was initially submitted to the Jacksonville Area Office of HUD on October 26, 1987 requesting a Feasibility approval. The joint walk-through occurred on January 19, 1988. In attendance from HUD were Mr. Jim Chaplin, Mr. John Mitchell, Mr. David Kay, Mr. Paul Grafton, Mr. Roy Truba and several other HUD staff members. Representing the Sponsor were William H. Walton, Jr., Joseph D. Weed, Jr. and the undersigned. After the walk-through, we were left with the impression that both Mr. Chaplin and Mr. Mitchell felt that Adams Plaza was a viable and beneficial project.

The first delay encountered was our fault. Prior to contemplating an application for mortgage insurance, Adams Plaza had executed a lease for 6,470 square feet of commercial space with a tenant which we felt would be highly beneficial to the overall project. The renovation of the space for this tenant was not completed prior to the filing of the application. As a result, after the joint walk-through during which the contractor was completing his work, we were informed that we must obtain a waiver from HUD Central for the work completed after the application had been filed. Our mortgage company, SMAI Financial Corporation (SMAI), submitted the request for the waiver to HUD Central on February 18, 1988. In March, 1988 we were informed that the waiver had been granted, but that it would be necessary to amend our applica-

WWH PROPERTIES, INC. • 33 WEST ADAMS STREET • JACKSONVILLE, FL 32202-3686 • 904-358-1833

tion revising our work write-up, cost estimates and architectural drawings to reflect the work which had already been completed. On April 20, 1988, we submitted the amended Feasibility application to the Jacksonville Area Office.

With the submission of the amended Feasibility application began an on-going series of interminable delays and problems. It took until October 24, 1988, one year after the submission of the original Feasibility application and six months after the submission of the amended application, to receive our formal notice that the Feasibility application was found unapprovable without securing approximately $1.4 million dollars of additional funding. Three primary reasons for the length of the processing period were given us by the Jacksonville Area Office:

- the Jacksonville Area Office was understaffed;

- processing of Section 202 applications and co-insurance applications had mandated time frames, whereas Section 232 applications had no priority; and

- in the Jacksonville Area Office's interpretation of the Handbooks, processing a Feasibility application required almost all the steps required to process a Conditional Commitment application, and therefore required a great deal more time than a typical SAMA application.

In order to correct the funding deficiency, it was necessary for us to raise additional capital. The limited partners of Regency House, Limited, which owns Adams Plaza, agreed to contribute an additional one million dollars ($931,000 has been placed in an escrow account as of this date). Obtaining the additional capital from the partners required contacting forty-five limited partners in several different cities and obtaining their consent to amendments to the Partnership Agreement. Once the consent was obtained, it was then necessary to solicit the funds from them over the holiday season. Also, arrangements were made for $450,000 in letters of credit to complete the additional funding. On January 25, 1989, three months after the formal notice of the deficiency, we submitted to the Jacksonville Area Office evidence that we had available the required working capital.

It then took until March 31, 1989, two months, to obtain approval of the three sentence letter committing to the letters of credit and to have a letter issued approving the Feasibility application. The Feasibility approval was for a mortgage of $9,354,900 with an operating deficit reserve requirement of $521,523. However, a surprise condition of approval was included: it was specified that we must agree to rehabilitate the building in accordance with the Secretary of the Interior's Standards for Rehabilitation. Further, before a Conditional or Firm Commitment application could be submitted, the Jacksonville Area Office required that the Florida Division of Historical Resources issue a "no adverse effect" ruling on our architectural plans.

The historic rehabilitation condition had been known by the Valuation Section since July of 1988, but had never been communicated to us until we received the Feasibility approval letter. That failure to communicate that information cost us an additional three months of delay doing work which could have been completed while the Jacksonville Area Office was processing our Feasibility application. On June 2, 1989, two months later, we obtained from the State of Florida our "no adverse effect" ruling. Work could not commence, however, on the Conditional Commitment application until we had determined that no changes in architectural plans would be required. Therefore, it took until June 29, 1989 to prepare and submit the Conditional Commitment application.

Review of the package for completeness took until July 28, 1989, and then until August 4, 1989 to prepare the letter advising us of the deficiencies. During the week that the letter was in preparation, we could not obtain a verbal listing in order to commence their correction. On August 11, 1989, one week after receiving the letter, we submitted the items necessary to correct the deficiencies.

We had expected that the processing of the Conditional Commitment application would be relatively expeditious, given the Conditional Commitment processing supposedly done during Feasibility stage. Four months passed, however, before we received any indication of the results of the processing. That was provided at a meeting on December 15, 1989 attended by, for HUD, Mr. Don Odenthal, Mr. Paul Grafton, Mr. Dan Scribner and a member of the Economics and Market Analysis Section, and for the Sponsor, William H. Walton, Jr. and the undersigned. At that meeting we were informed that the mortgage amount was to be reduced to $8,642,400, a reduction of $712,500, and that the operating deficit reserve requirement would be increased to $2,177,733, an increase of $1,656,210. The mortgage amount was decreased primarily because of an increase in HUD estimated expenses; the operating deficit reserve was increased primarily because of a reduction by HUD in the anticipated absorption rate from approximately 6.5 units per month at the time of the Feasibility processing to approximately 3 units per month at the time of the Conditional Commitment processing. (When asked how things could have changed so dramatically, one of the reasons provided was the time elapsed between the Feasibility processing and the Conditional Commitment processing!)

At the December 15, 1989 meeting it was indicated, if we could present evidence justifying reevaluation, that the Jacksonville Area Office would reconsider its decisions. A follow-up meeting was held on December 18, 1989 at which we presented an analysis, based on the current operations of our nursing home, which showed that the project was feasible given our existing financial resources at an absorption rate of 4 units per month. On December 19, 1989, we were informed by Mr. Odenthal that Mr. Grafton and Mr. Kay were unwilling to reconsider their preliminary findings. The decision not to reevaluate was made even though they had apparently made a substantial error during the Feasibility processing, and even though Mr. Odenthal indicated a possible range for the absorption rate of 2-8 units per month. On February 6, 1990, HUD issued their letter finding the Conditional Commitment application unapprovable because the Sponsor lacks adequate working capital.

One other point should be noted concerning the processing of our application. In a telephone conversation with Mr. Paul Grafton after the December 18, 1989 meeting, I commented that he must feel that Adams Plaza is an inferior project given the absorption comparables he quoted; he agreed that that is his feeling. If so, why did Adams Plaza get Feasibility approval? We could have "cut our losses and run" over thirteen months earlier.

Because we believe in this project, we are continuing our efforts at the present time to raise the required funds to proceed. However, our loan officer at SMAI has been told by Mr. Odenthal that processing of the Firm Commitment application, if we can raise the required working capital, will take six to nine months after submission of the application. Our working capital will be eroded by approximately $25,000 per month during this processing.

What have been the outcomes of trying to process through HUD a mortgage insurance application without the use of "consultants" or political influence? The following are but a few:

- huge financial carrying costs, only part of which are the following incurred between October 1987 and March 1990:

Mortgage Interest	$490,181
Property Taxes	147,548
Property Insurance	17,741
TOTAL	$655,470

- opportunity costs in the millions of dollars resulting from not being in business earning income and possible inflationary increases in renovation costs during the two and one-half years of processing time to date;

- incalculable opportunity costs associated with, as only one example, increased competition over time;

- a complete loss of our credibility with our investors and creditors who blame us for the delays and who wonder about project viability given the "flip-flops" by HUD, the loss of which credibility also makes it much more difficult to raise the funding now required by HUD (one of our investors stated, "How can you shave in the morning?"); and

- tremendous frustration from our complete inability to plan, not knowing how long it will take HUD to process our application or what surprise will next be given us.

What can be done to correct the problems which we have encountered? The following four suggestions will help to eliminate the incentives for Sponsors to "end run" HUD staff:

1. Mandate reasonable processing times for all stages of all programs.

2. Provide adequate staff to meet the mandated time frames. The FHA should be a net revenue producer for the federal government.

3. If it is deemed desirable from a policy point of view to have in place the FHA mortgage insurance programs, some incentive should exist to approve good loans. At the present time there is no incentive to approve any loan, and in fact typical bureaucratic incentives work to discourage approval of loans. (Nothing approved means no mistakes, and no mistakes means no trouble.) Because the majority of the HUD employees are career civil servants, it is possible over time to evaluate both their loan quality and loan production.

4. Presumably FHA mortgage insurance programs exist because certain types of projects are deemed too risky by private financiers, but are considered to be socially desirable. Evaluation of such projects requires highly trained and knowledgeable staff. As the industry is now realizing, Board & Care projects require not only real estate analysis, but also business analysis. Several times I tried to discuss our Business Plan with the Valuation staff. It is key to the success of Adams Plaza. In my opinion, however, Adams Plaza was evaluated purely as a real estate transaction because Board & Care is new to HUD.

I hope this information and my analysis will be of use in identifying required restructuring at HUD. The FHA mortgage insurance programs can be very beneficial in stimulating the development of housing alternatives for many different segments of our society. To utilize them at the present time, however, one must have very "deep pockets" and a very high frustration threshold if one is going to play by the rules. Once again, thank you for this opportunity.

Sincerely,

REGENCY HOUSE, LIMITED

Paul B. Hazlett, President
WWH Properties, Inc.
Managing General Partner

PBH:kwp

EXECUTIVE AND OMB OVERSIGHT OF HUD

MONDAY, APRIL 23, 1990

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
HUD/MOD REHAB INVESTIGATION SUBCOMMITTEE,
Washington, DC.

The subcommittee met at 1:35 p.m., in room SD-538 of the Dirksen Senate Office Building, Senator Bob Graham (chairman of the subcommittee) presiding.

Present: Senators Graham, and Mack.

OPENING STATEMENT OF SENATOR GRAHAM

Senator GRAHAM. We will call the meeting to order.

Today our subcommittee will be looking at the role of the Executive Office of the President in overseeing the Department of Housing and Urban Development. Specifically, we will examine the role of the Office of Presidential Personnel in placing political appointees at HUD, and the role of the Office of Management and Budget in overseeing HUD's budget and management activities.

We cannot underestimate the influence of the Executive Office of the President on Federal agencies such as HUD. Through organizations such as the Office of Management and Budget, and the Office of Presidential Personnel, the President influences heavily and sometimes totally controls the lifeblood of agencies—their budgets, and their personnel.

Hopefully today we will gain some insight on how the Executive Office of the President influenced HUD during the Pierce years, and particularly in the case of OMB, how we might make the future role a more successful and effective one.

Our first panel today consists of three former employees of the Office of Presidential Personnel who assisted HUD in placing political appointees during the period 1984 through 1988. On Friday this subcommittee conducted a hearing touching upon the staffing problems at HUD during the 1980's. We found a "brain drain" of career employees which has been exacerbated by unqualified political appointees assuming greater control of the organization.

We look forward to hearing the views of our first panel on these staffing issues, as well as gaining insight into the efforts of the Pierce administration, or lack of effort, to see committee and qualified individuals working at HUD.

I want to thank the members of our first panel for their participation. The panel consists of Anne Banning, the Associate Director at OPP responsible for placing HUD personnel during the period 1985 to 1987; Charles Dutcher, the Associate Director of OPP responsible for placing HUD employees during the period 1987 through 1988; and Mark Robbins, the Deputy Associate Director for OPP who handled HUD placements during the period 1984 through 1988.

We appreciate your being here today. It is the practice of the Banking Committee to swear all witnesses, so I would ask that you please rise and raise your right hand.

[Panel sworn.]

Senator **GRAHAM**. Ms. Banning, would you like to start?

STATEMENT OF ANNE BANNING, FORMER ASSISTANT DIRECTOR, OFFICE OF PRESIDENTIAL PERSONNEL; CHARLES DUTCHER, FORMER ASSISTANT DIRECTOR, OFFICE OF PRESIDENTIAL PERSONNEL; AND MARK ROBBINS, FORMER DEPUTY ASSISTANT DIRECTOR, OFFICE OF PRESIDENTIAL PERSONNEL

Ms. **BANNING**. Yes.

Senator **GRAHAM**. Do you have an opening statement?

Ms. **BANNING**. I have no opening statement.

Senator **GRAHAM**. Mr. Dutcher, do you have an opening statement?

Mr. **DUTCHER**. No, I don't.

Senator **GRAHAM**. Mr. Robbins?

Mr. **ROBBINS**. No, sir.

Senator **GRAHAM**. We have been joined by my colleague, and the ranking member of the committee, Senator Mack.

Connie, do you have an opening statement?

Senator **MACK**. Thank you, Senator Graham. I do have an opening statement, but I think I will just submit it for the record and just go ahead and get the hearing on.

Senator **GRAHAM**. Very good.

OPENING STATEMENT OF SENATOR MACK

Senator **MACK**. I am pleased to say we are well on our way of approaching a conclusion to this subcommittee's hearing schedule.

We have looked at a variety of problems at the U.S. Department of Housing and Urban Development, focusing on housing policies, programs designed for delivery of these policies and the people charged with the implementation of policies and programs.

Our discussion today will focus on the role the Executive Office of the President plays with regard to the oversight of the agencies. As we do so, I will reiterate what I have said in the past, and that is, that while the importance of oversight and management should not be underestimated, it is first and foremost the responsibility of Congress to enact laws which are responsible and discourage abuse. As it is said, a good law is not only one which allows good people to do good things, but one which prevents bad people from doing bad things.

Our investigation has focused to a great extent on programs such as Mod Rehab and Coinsurance. In the case of Mod Rehab we saw a great deal of abuse resulting from the inviting nature of a big pot of discretionary funds. In the case of Coinsurance, we saw abuse resulting from a program that guaranteed 100 percent Federal Government backing with virtually no risk on the part of the Government's partner.

We should keep these programmatic flaws in mind as we examine the role of the executive branch in oversight.

Thank you, Mr. Chairman.

Senator GRAHAM. Could you give us some background as to the procedures that were used within the Office of OPP and how the office related to line agencies in determining such factors as the allocation between career and political appointees? What were the criteria for making that judgment, and for those positions that were designated as Presidential appointments, what was the procedure for identifying appropriate personnel?

Mr. DUTCHER. OK. I will lead off, Senator.

It is important to remember that in the personnel ranks you have certain levels of appointees. Certainly the most important people we dealt with were the Presidential appointees with Senate confirmation. We, Anne and I, spent probably the greatest amount of our time finding these people, placing them and recommending them ultimately to the President.

Then there was the confirmation process, having the Senate confirm these individuals to those positions. It was my experience, and I'm sure others, that, finding these people was not always easy, but we spent a great deal of time, certainly with the input of many people from industry, local governments, and certainly the Senate and the Senators themselves, trying to find qualified and competent individuals to fill these positions.

The second tier of people are in the SES level, management-directed positions, and we tended to spend a certain amount of time with them, but certainly our primary focus was at the PAS level.

At the schedule C level, those positions below grade 15——

Senator MACK. Excuse me, just for the record, "PAS" stands for?

Mr. DUTCHER. "Presidentially Appointed Senate Confirmed." So if I say "PAS," that is what I am talking about. They are the assistant secretaries, the Cabinet Secretary, the deputy secretary.

At the level of grade 15 and below. There are schedule C appointees. "schedule C" refers to an appointing authority within the statute at OPM. Schedule C appointees are often referred to as "political appointees" and tend to be the assistants to the assistant secretaries, et cetera, and normally would be in grades 7 to 15.

We certainly spent a great deal of time trying to find these individuals and place them in agencies to work for the assistant secretaries, and ultimately the secretary. These people at the schedule C level and at the SES level, below the PAS level, report in the end to the secretary. The President's authority for appointment only extends as far as the PAS level. But we certainly felt it was important to recommend below that level; however, these individuals were hired and fired at the pleasure of the secretary.

And as far as career/noncareer allocations, the SES level, a statute prescribes that you cannot have, I believe, more than 10 percent of the total SES population across the Government from the noncareer ranks, and up to 25 percent of any one agency. So for each 2-year period, the Office of Personnel Management will come out with an allocation for each of the agencies designating how many appointees in the SES level they are allowed to have, and then working down from that mathematically, figure percentagewise how many political appointees they are allowed to have at the SES level.

Of course, at the PAS level that figure is set by statute. When you have legislation creating an Office of the Assistant Secretary of whatever, you set the number of those individuals.

At the schedule C level, the grade 15's and below, as long as they meet certain criteria set by Office of Personnel Management, these positions may be established. It is well known and kept track of by all kinds of people—the media and others—that the Reagan administration made a substantial number of schedule C appointments, but not any greater in percentage terms than the Carter administration.

The reason I know about this is that one of the things I did when I was at the Office of Personnel Management was keep track of this kind of information, and we had a computer that kept track of the statistics and reported them not only to the Senate but to the White House, OPM and others.

To summarize our time was spent looking at the PAS level in so far as it led to recommendations to the President for the use of his authority to appoint people; however, we also made recommendations to the agency concern appointments by the Secretary within certain offices at HUD and other agencies.

Ms. Banning. I think it is important to also note that for PAS's it was always, although we made recommendations to the President, it was always done with the concurrence by the Secretary, and that it was not just a White House recommendation but it was done with their agreement and concurrence.

Mr. Robbins. Looking at it from a slightly different level, Anne and Chip as associate directors spent a great deal of their time on the Presidential appointees. One of the duties I had was to take care of the paperwork of getting the schedule C's and sometimes the SES's on board, which took up like I say a great part of my time.

It is important to remember that the Office of Presidential Personnel has absolutely nothing to do with career SES and civil service positions that are not Presidential appointments. There would be many times when we would get a call from a political operative in the field, or a Senator, or a Congressman who was interested in placing a constituent or a friend or someone they had run across in a university or a college that had particular expertise, but the position that that individual might be interested in was not political. And when that was the case, we had absolutely no authority, and we were up front about that. It was one of those situations where we would recommend they go to OPM to find out how one applied for that particular career spot.

We were instructed early on and told to remember our place when it came to that; we had nothing to do with the career civil service.

Senator Graham. In what you have just described as the general practice, was there anything peculiar about HUD's relationship to the policies or practices of OPP during the tenure of Secretary Pierce?

Ms. **Banning**. I don't want to say "peculiar," but I would say that they were a more distant agency in dealing with personnel.

Senator **Graham**. Could you define what "distance" means, maybe with some examples?

Ms. **Banning**. I worked for four agencies and numerous boards and commissions, and I would say that we worked very closely with those agencies. I think the best one to talk about would be Education when we worked very closely with Secretaries Bennett and Bill Crystal who was the chief of staff. And when you have very great working relationships, as we did with Education, I would say it was a very smooth operation and you could work very closely and get things done quickly.

I would say the only thing that was the slightest bit peculiar or different was just the discussion between the agency and the White House, or the lesser degree of discussion.

Mr. **Dutcher**. Concerning the PAS-level candidate, no recommendations went forward to the President without the concurrence of the Secretary. In my experience in dealing with HUD, that was where problems at the PAS level tended to happen, because the Secretary would not give his concurrence and you would not hear from him or the agency for weeks. That was a real problem for me because I was responsible for seven other departments and numerous smaller agencies.

When you are dealing with that many different organizations, the one that tended to be slow in getting back to you could create problems, and especially when we felt it was our responsibility. If there was a position there, it needed to be filled. So I guess when we say HUD wase difficult to deal with, we really felt a difference between the agencies. The Department of Education and Labor, both of which were in my portfolio, were very easy to deal with. The same thing with HHS. Secretary Bowen was great to deal with.

We had a good rapport, and I think it is important, from an oversight viewpoint, that the White House and the Cabinet agencies work together to make sure these positions are filled. If those positions sit vacant, then you can have all kinds of problems.

Mr. **Robbins**. I think that we found over the various years that we all worked with HUD, and with the other agencies, that the degree of our interrelationships with the departments and agencies were set to a great deal by the tone the Secretary had—by the Secretary's management style. We had several Secretaries such as we've mentioned, Bill Bennett, who was a hands-on manager, and you can disagree with his policies but I don't recall ever hearing anyone criticize the management styles within that agency itself.

He had a hands-on management style, and so his people were extremely accessible. I don't think it is any secret that Secretary Pierce had a different management style, and that we found difficult to work with and around.

Senator **Graham**. Did you ever report that difference in relationship to a superior such as the chief of staff in the White House, or the chief of the Office of Presidential Personnel?

Mr. **Dutcher**. I think they were certainly aware of the problem and of that relationship, and it was no secret that there were other offices that had a similar problem at times——

Senator **Graham**. With HUD?

Mr. **Dutcher**. With HUD. And, you know, I remember we would talk among ourselves at the staff level that, yes, they're giving us some problems, and they're slow, but you just shrugged it off since they treated us the same way. So it was sort of an across-the-board thing.

Senator **Graham**. The last question, was that peculiar to your office? Did it apply to other offices that dealt between the White House and HUD?

Ms. **Banning**. I don't know how we could speak for other offices, but in my experience it was an inactivity that caused certainly a problem in our office, and I would imagine other offices, but I have no personal knowledge of that.

Senator **Graham**. Do you have any knowledge of anyone from your office having communicated this difficulty with HUD to someone who was higher up in the Executive chain of command?

Mr. **Dutcher**. I was never privy to any of those conversations, if they happened, you know——

Senator **Graham**. Did you personally ever communicate——

Mr. **Dutcher**. Oh, certainly.

Ms. **Banning**. All of us did.

Mr. **Dutcher**. We all worked for Bob Tuttle, and I can tell you that on many occasions I would say, "Bob, why won't HUD call us back? Why can't we get this moving?" And he was saying the same thing to me. So certainly——

Ms. **Banning**. Whether or not he passed on that information, I don't know.

Senator **Graham**. Senator Mack?

Senator **Mack**. Thank you, Senator Graham.

I want to just kind of touch for a few minutes on some background, just to make sure I've got the proper structure put together.

You work for the White House? For the administration? You are career people?

Mr. **Dutcher**. No. We were all political appointees, Senator.

Senator **Mack**. All of the folks we're talking to are political appointees, as well. And you worked, though—I am picking up a term here—worked "for" these agencies in the sense of—well, tell me what that means when you say you "worked for these agencies"?

Ms. **Banning**. What that meant was that each of us were assigned agencies to help them fill these positions that we've talked about, the Presidential appointments and that type of thing. HUD happened to be one of the agencies that I had, along with Labor, Education, HHS, and other boards.

When I left, Chip was my predecessor——

Mr. **Dutcher**. Successor.

Ms. **Banning**. I mean, successor, right. And Mark was both of our deputies during my tenure, and during Chip's, as well—or Charles.

Senator **Mack**. And between the two of you, that covered how long a period of time?

Ms. **Banning**. I was a year.

Mr. **Dutcher**. I was 2 years.

Ms. **Banning**. Three, total.

Senator MACK. And so you were there for the 2 or 3 years?

Mr. ROBBINS. And I was there right before Anne, under her predecessor. I was there just under 4 years.

Senator MACK. So your function really was spent in a great deal of time trying to find people. I was under the impression, frankly, that probably one of the difficulties in your job would be to weed out, if you will——

Ms. BANNING. Screen.

Mr. DUTCHER. Certainly.

Senator MACK. To "screen," that is a better word—to screen people, as opposed to trying to find them. I mean, in the sense that I just had this feeling, having just been elected to the Senate in 1988 and coming in with a new administration, I heard from lots of people around my State that had an interest in positions with government. As a result of that, my reaction was that you guys were overwhelmed with the numbers and it was really a question of trying to put the right people at the right place, and making sure you got qualified people. Is that fair?

Mr. DUTCHER. That is fair, and it is also important to know that, while we heard from lots of people—I think at one time we had over 55,000 résumés in our résumé bank—these were not necessarily the same people we wanted to put in our positions. It was important then to go out and find the right person. We used to say that the person who wants the job may not necessarily be the person you want to recommend to somebody. You may want the person who is busy in a career and has certain expertise that you want to bring to that position.

I know that was certainly true when I had HHS and we were looking for a head of the National Cancer Institute. It was important to find somebody who was a physician and met certain criteria. One of the things to remember about each of these positions, when we would recruit we would know the position description for that position, the criteria that we must meet for this individual to function properly and do a good job.

Senator MACK. Do you feel like that you were—I mean, I think that is an interesting point. I am just trying to imagine myself all of a sudden being in one of your positions trying to fill a slot that I had never worked at before in trying to go down the list of criteria as to the qualifications and the requirements and the skills in trying to fit all of that together to be able to make a determination about whether I really knew enough about the spot to draw the proper conclusion. That must be difficult.

Mr. DUTCHER. It is difficult, but you also would reach out to others who had prior experience there and who were knowledgeable of some of the issues.

Senator MACK. Prior experience at?

Mr. DUTCHER. At that agency, or who were currently at the agency and you would ask what really does this job do?

Senator MACK. Would you have people within—let's see, I want to call it the right name—is it OPP? Would you have people in OPP who had been there for long periods of time who could give you that kind of staff assistance?

Mr. DUTCHER. No, not as far as having knowledge of the position. I mean, certainly if you had filled this job three times you knew exactly what you were looking for, or who you weren't looking for, as the case may be. So you were very much in sort of a balancing act.

Anne had professional recruiting experience, so she brought something to the job that I didn't have, because I'd never done that before.

Ms. **Banning**. I was going to say, I didn't find it any—I didn't find it to be brain surgery to learn too much about what the jobs entailed and what the requirements were, because there is lots of literature on what the jobs are about. Then you also talk to the agency about what they are looking for. So just for information's sake——

Senator **Mack**. I guess what you are saying, if I had spent as much time as you in filling those kinds of positions over the years, I wouldn't find it particularly difficult either?

Ms. **Banning**. Right. I mean, I don't think it is a real tough thing. It just takes some review, that type of thing.

Senator **Mack**. Let me raise another point, then.

Ms. **Banning**. OK.

Senator **Mack**. From maybe a little bit different perspective, because it sounds like there are a lot of potential points of pressure on you. One is the agency itself—that is, the Secretary——

Ms. **Banning**. That's right.

Senator **Mack** [continuing]. And whoever might be on the Secretary's team. So there might be a couple of people coming from that direction. Then you are going to have people like myself, for example, who have people in my State, all the different areas that you mentioned that would come to me and indicate an interest in a particular position.

Then you have got, I would assume, the White House itself. Maybe there are people within the administration that have people they feel ought to be in certain positions. Then you have the political activist back in whatever particular State. So you have got a lot of different points of pressure that are coming on you, and you have to use your discretion as to that input, plus try to balance that with what you understand are the requirements for the job.

Where would you change things if you had to change them, I guess? Or maybe I ought to back up and say: Is there a problem?

Mr. **Dutcher**. I am not sure overall there is a problem. Certainly what you just described as the various pressure groups, if you want to call them that, are there. You just deal with it. You deal with the Senator who calls and wants to recommend a candidate strongly. You deal with the interest group that calls, and you make a note of that. And I know when we would finally make a recommendation to the President of an individual, or a group of people, we would list who was supporting them, who was opposing them; you know, Senator Mack had called, or so-and-so had called, a Congressman, a Governor. So we kept track of all those things, not really as a tally sheet or a scorecard, but certainly to give some indication of whether there was support for or opposition to this individual.

We certainly heard often from people who opposed people for a position.

Senator **Mack**. If you could give me kind of a one, two, three of what you consider—in other words, what was the most important thing for you to take into consideration? Then what was the next? Then what was the next?

Mr. **Dutcher**. I think overall we used to talk about the two "C"s. We had "competence" that was No. 1. The person had to be competent for the job.

No. 2, you had to have commitment, commitment and shared a philosophy with the President.

And then there was a third, the specific criteria which were listed in that position description.

Senator **Mack**. Pardon?

Mr. **Dutcher**. The position description and all the various criteria that individual would have to meet in order to fulfill the obligations of that office.

Mr. **Robbins**. Senators, we were probably aptly described, or could be aptly described as the funnel of information. We kept the books and records on individuals so that we could, as Chip said, create a tally sheet so that when a recommendation, or when a group of individuals went up to the President and his senior staff, they had the appropriate information they needed to make a well-informed, educated decision on who would get a particular position.

Senator **Mack**. Now when you would—you said you would meet with the President or the staff? Who would you all meet with? When you were trying to fill a position at HUD, was it Bob Tuttle that you would then go to and kind of outline from your perspective, here is the funnel of information, if you will?

Mr. **Dutcher**. We would have an ongoing dialog with Bob, and then there would be a senior staff meeting where things like this would be discussed. Every Wednesday Bob met with the President, and then we would hear back.

Mr. **Robbins**. And not only were we coordinating the various pressure groups on the outside, but within the White House there are different offices that would have their input, too. The Old Executive Office Building isn't that large. It is not a great effort to get the feeling of OMB and what they feel is needed for a particular position, and the Office of Policy Development who were people more skilled in a specific area than we were.

I mean, these were individuals that knew the particular policies. They are the ones that would brief us on what kinds of—what the criteria were that we needed to fill. If the job was a legal job, we usually passed that candidate by the President's Counsel to see if that individual's qualifications were either recognized or known.

Mr. **Dutcher**. Legislative affairs. Every prospective nominee would be cleared through legislative affairs.

Mr. **Robbins**. So we just wanted to make sure that not only did we have all the information we needed to pass along up the totem pole to the President, but we wanted to make sure that those agencies, or not agencies but those offices within the White House had an input, too. Because once that individual was in place, those were the people within the White House they would have to deal with.

We were at the very beginning of the process for that particular man or woman when they were coming in to be appointed. You know, once they got their job, once you folks had confirmed them and they were sworn in, unless for some particular reason they needed special staffing needs, we were basically out of their life. They then started to deal with OMB and Office of Policy Development.

Senator **Mack**. You mentioned the two "C"s. "Competence" and?

Mr. **Dutcher**. Commitment.

Ms. **Banning**. Commitment.

Senator **Mack**. How often did competence and commitment win out over the other considerations that you had to think about?

Ms. **Banning**. I would say most often.

Senator **Mack**. So what I would draw from that is—I mean, I think there is the perception that the responsibility is to take this group of political interests and find them a spot in the administration. And what you are really saying is that, while you have to funnel in all of this information, bottom line is your responsibility is to competence and commitment.

And you say that almost all of the time that competence and commitment wins out?

Mr. **Dutcher**. It is very much a funnel, as we talked about. There are so many résumés, all from people who would like a job. There aren't that many jobs, and there certainly aren't that many jobs that the President has something to do with.

So when you take all that information together and feed it in, there were lots of people over 8 years who never got a position, who weren't just hired to be hired, and we heard from them a lot of the time.

Senator **Mack**. I'm sure you did.

Ms. **Banning**. Quite regularly.

Mr. **Dutcher**. On a regular basis. And it wasn't as if you could have waived a wand and hired these people and found them a particular niche so that they could have come into government and contributed something, because that's what they really wanted to do. When we talk about political appointees, we often focus on the political side, but these are citizens who are interested in their Government, and they are interested in contributing to their Government for a specific amount of time.

It was hard to tell these people: I'm sorry, but we can't use you right now. I don't have anything I can recommend you for. You are not what we are looking for today. That is a very difficult letter to write or phone call to make to somebody.

Senator **Mack**. Let me just finish up my portion of this and turn it back to Senator Graham.

If I remember correctly, there were approximately 150 positions at HUD that fall into this category. Rather than for me to try to draw my own conclusions from what you all have said, how would you—would you say that the people who filled those 150 positions were primarily people who fit that category of competence and commitment in the 3 years that you were there?

Ms. **Banning**. I had, under my tenure, I think there were two PAS's that came in. So most people were already in their functions. But I think it is important to note also—I see we are going with something that I might want to clear up about what "commitment" means.

What "commitment" means actually to us is we were very anxious to find people that we felt were committed to the philosophy of the President.

Senator **Mack**. Yes. No, I understood that.

Ms. **Banning**. OK.

Mr. **Dutcher**. I think during my tenure there might have been two or three PAS-level people. None of them was very controversial at the time, and I can honestly say that I don't think I ever recommended anybody that in my mind didn't meet all the specific criteria for that position. Either I felt good about recommending those people or I would have tried to do everything I could to make sure that we didn't recommend that person.

Mr. **Robbins**. Hindsight is obviously always clearer than foresight, and I think if you look back on some of these appointees perhaps there were some problems. I can honestly say out in Los Angeles this HUD scandal is not front-page news, so I am really not quite sure exactly what the allegations against the various individuals are at this point.

Our job, part of our job though was working under a handicap, and it is a handicap that I don't know how to address, and I don't think anyone else does. You folks are grappling with it up here right now with the various bills and proposals on ethics legislation. And unfortunately as we begin to tie in what kinds of candidates you can consider, you make them put their financial backgrounds into blind trusts, they can't do this when they leave, they can't do that before they come, there are all kinds of limits. What you find is that you have got a shrinking pool of qualified candidates.

You have young people who are eager to serve but do not necessarily have the background and the maturity to do so well, and you have older candidates who have the background and perhaps have the skills but a lot of times do not have the energy it takes to come in, spend 2 years fighting with the bureaucracy hammering out negotiations with the Hill—you know, it is a completely different world here in Washington than it is for a businessman or woman out somewhere else outside the beltway.

And you add on top of that what we are telling these people: Come to Washington. Take a $150,000 pay cut. Open up your entire life to scrutiny for 2 years of hassle. And, by the way, you won't be able to do anything when you leave.

The only candidates who return your calls after you have had that kind of conversation with them are those that feel they can either truly contribute to the President's agenda and help make HUD or whatever department or agency a better place, and in so doing make the country a better place, and those were the kinds of people you just loved to talk to because you would come out of those interviews with a sense of renewal that there were actually people out there who believed that they could make a difference.

Or, you find that you have got hacks, people who want to use the office. Geeze, if I spend 2 years here I can then make a fortune when I leave. Those people embarrass me. That is not why any of us got into politics. That is not why I supported President Reagan, and it is embarrassing when that comes out. But, you know, you work with what you've got. You work with the people who are interested. You can't just pull a CEO out of his or her job and bring them to Washington. They have to want to come.

And I think as Chip said, at the time these recommendations were made we were firmly of the belief that they had both "Cs"—they were committed to the President's agenda, and were competent to perform the duties the President wanted them to perform.

Senator **Mack**. Thank you.

Senator **Graham**. I am trying to ask questions that look in two directions from where you stood. One is to look up to the people that were in the chain of command between you and the President, and then I am going to turn and ask some questions looking back toward HUD itself.

Continuing to look up the chain of command, did you find that HUD was a relatively more, or less, or about equally attractive agency to the others that you had the responsibility for? That is, was the pool of candidates for HUD in terms of depth and quality about the same as you had for Labor, or HHS, or Education, or Interior, or other executive agencies?

Mr. **Robbins**. Well, as a pool we did not deal with that often. You know, Secretary Pierce obviously had been there since day one, and there wasn't until the last year, there wasn't a lot of turnover. Occasionally we would get people who would express an interest, from my level dealing primarily again with SES and schedule C's and helping Anne and Chip with some of the administrative angles of the PAS appointment process.

It is sort of like comparing apples and oranges. I mean, within the housing industry and city governments, yes, HUD was extremely popular and there was always a pool of candidates, and they always had recommendations.

HHS is different. You had doctors and scientists and public social service organizations that were busy recommending candidates. So I don't know if you can set the agencies aside and say HHS had—you know, we had 10,000 inquiries this month about jobs at HHS, and only 100 at HUD. It just doesn't work that way.

Dealing with the young people I did coming in, you're right, HUD was not the first agency on their list of job desires. They all wanted State, and Defense, and to be an Ambassador's assistant in Paris, and what have you.

Ms. **Banning**. I would say that HUD was much less desirable than any other agency I had.

Senator **Graham**. Well, could you elaborate on that, Ms. Banning? Why do you think it was less desirable?

Ms. **Banning**. I will have to think on that one. I think that there was just a lot of inactivity, and I don't think that anyone saw HUD as a particularly action-packed agency where they were going to get a lot of—let's say, for example, at HHS there were different people who were going to be working on AIDS, and different people who were working on issues that were very topical.

I think at HUD it was just an "agency," just kind of not riding the crest of new initiatives.

Mr. **Robbins**. And again a lot of that goes right back to the Secretary's style. You know, I have absolutely no idea how HUD's recruitment efforts are going these days, but I would assume under someone like Secretary Kemp who is slightly—or has a higher profile and carries with him a reputation for affirmative initiatives, I think that probably brings with it some excitement that a manner and style like Secretary Pierce's doesn't—which is not to say that one is any better or worse than the other; it is just a fact of life that when you've got someone who is high profile, they are bound to attract people who are interested in working for them.

Mr. **Dutcher**. And when you are dealing with an agency where the Cabinet Secretary has been there 6 or 7 years, has a set way of doing business, has a set team, has a set set of policies, it may not be as attractive to somebody on the outside as for example the Department of Labor where there was a change of Secretary a couple of times, or HHS, or Education where there was a new team coming in within the framework of this ongoing administration with new ideas, and new talent.

If you are coming from the outside, you would think that the possibilities could be brighter joining a team that is new as opposed to joining one that has had people there for 7 years. It certainly presents different kinds of problems when you're trying to find somebody.

Senator **Graham**. Well, in that context it is surprising that at our previous hearings we've received information that indicates that HUD had a higher percentage of political appointees than did the other agencies that you have just listed.

If you had a less attractive agency, you have less vigorous leadership, a less exciting or clear sense of vision and mission. So it seems odd that the statistical result would be to have more political people than an agency that had more positive characteristics.

Ms. **Banning**. I wasn't aware that that was a fact.

Mr. **Dutcher**. I wasn't aware of that, either. But one thing you might look at is the substantial decrease in the number of positions at HUD overall, counting career and noncareer positions. I think like during the first 2 years of the Reagan administration, there was a substantial downsizing of HUD from its previous level. So I don't know what the percentage would be as far as political versus career, but certainly at the SES level that is set in law. They couldn't have had more than they were allowed——

Senator **Graham**. You are talking specifically at the schedule C level?

Mr. **Dutcher**. I do not have the figures, but I know we kept track of those things and they were printed in the paper every once in awhile. As far as the numbers over a period of time, OPM keeps statistics on those things about number of schedule C positions going back to the Ford administration. And I always remember that we were somewhere in the ball park, close to the figures of the previous times.

Senator **Graham**. I am editorializing, but the suspicion is, and unfortunately some of the evidence that has come out over the last several months might indicate, that this was an agency that was attracting those people who did not have the highest "CC" quotients, people who were looking for jobs in order to advance their subsequent career. There were a number of people whose names we do not have to mention here who spent a period in HUD, left, and substantially increased their personal wealth—there is some anecdotal evidence that that was the case.

Do you have any observation to either dispute that premise, or add substance to it?

Ms. BANNING. Well, I sort of wonder what the two CC's have to do with someone later going out and benefiting from their job. I think that is sort of a hard thing to tell. I think that if you are hiring someone who is both committed and competent, you know, I don't know that I would be able to tell what someone would then do afterward with it.

Senator GRAHAM. I am just suggesting that from looking at the resume of some of these people as they went into this job, and looking at their subsequent activities on the job and their acquisition of wealth after they left the job, I don't think they had a very high commitment quotient if you define commitment as believing in public, as opposed to personal, gain.

Mr. DUTCHER. And that is the sad commentary, at least for us.

Senator GRAHAM. Let me ask a final question before we turn inside HUD. You mentioned commitment was commitment to the President's goals, and it was clear that the President did not have a very high goal to housing. I might add that he was elected by the American people, and that is a political judgment to which the American people have every right to elect somebody to carry out.

But as was said by one of our panelists on Friday, during his time as HUD employee in the early 1980's, he was given a budget to oversee an agency which would not exist in 4 years if that budget was carried out.

Since commitment to the President's program involved dismantling the Department of HUD, how did you go about selecting people whose job was essentially to be a mortician?

Ms. BANNING. Well, I guess what I mean by commitment is to take Health and Human Services for example. If I had to interview someone for a job at HHS who believed in socialized health programs, that would not be an effective person to be at HHS under Reagan.

On the other hand, there were job duties that had to be performed. We would certainly never want to hire someone who would not want to carry out the job duties and be a mortician, but rather carry out——

Senator GRAHAM. But if the goal is to dismantle the Department, and that was the policy——

Mr. DUTCHER. Senator, by the time that Anne and I were there, HUD was not going to be dismantled by the sixth year of the Reagan administration. Maybe the group that was there for year one, maybe they had a look at that. I have no knowledge of that. But I can tell you that from my experience, I did not go around looking for anybody with mortician's qualifications.

Senator GRAHAM. The specific program that we are concentrating on within HUD was the Moderate Rehabilitation Program. Even as late as your tenure in office, that was a program which was targeted for termination. How does that affect the kinds of personnel who are going to have responsibilities for management of a program where their goal, their responsibility, their commitment is to that program's elimination?

Mr. ROBBINS. Well, Senator, you can support the philosophical political position of dismantling—I don't want to use HUD because

I don't think that was ever the goal of the Reagan administration—take an office within HUD for instance, Community Planning and Development, which is an office that is set aside to distribute funds to whomever. I'm not even quite sure what the standards are.

You have got to take into account, though, the fact that the people here on the Hill are not going to allow the President just to dismantle an agency. That has to go through the budget process. There will be debate, and there just was not support up here for dismantling.

A doctor, when he has a terminal patient, does not sit around and watch that patient die. You do what you have to do to keep it going. You are still looking for individuals with management qualities and capabilities who can keep the programs running. I do not think any of us sat around wanting to find someone who would affirmatively destroy a program, because even though that may accomplish a philosophical goal you are going to ruin your reputation, you are going to ruin the Department's reputation, and you are going to hurt the President. And that is something that we were trying to avoid.

Senator **Graham**. Would you suggest how? On a scale of zero to 10, what grade would you give yourself, to your ability to avoid those pejoratives?

Mr. **Robbins**. Oh, I'm probably not very qualified to grade myself, Senator. I would suggest though that, at a Department like HUD where you have a lot of money and a lot of vested interests that have been around for 25 years, and you're seeing the same people going back and forth—not just the revolving door between Government and private service, but you have individuals who will go from one development company to the next and who will go into the lobby groups. It's a very insular community.

I think, if anything, Presidential personnel and White House involvement in the appointment process can be looked at as a safeguard.

If the Department had had more discretion in selecting its own appointees, without having to go through us, which at the PAS level, they couldn't do because it's the President's constitutional duty to appoint these individuals.

But, I think, had HUD had a more free hand, you would have had many, many more problems than you've got now. And they'd be hard to imagine, but—[laughter]—but, we were outsiders helping to find people who we though were qualified. I think, with those individuals we dealt with at HUD at every level—maybe not so much the schedule C level, which were just young people, but at the SES, which is management, and at the PAS level, HUD definitely had lists of candidates who they wanted for any particular job.

And, you know, it's no secret that those people were all coming from the same pool. And I think, if anything, we were a break to protect against this increased cronyism.

Yes, I have long supported decentralization. I always consider myself a good Republican in that respect. But, perhaps maybe the answer is tighter Presidential personnel, White House control over the appointment process.

I don't know how that would work practically. Obviously, you can't have people there that the Secretary can't work with.

But it certainly is an idea to look at. And, you know, this is a human problem and any rules are going to have exceptions. And any time you legislate some kind of—or not even legislate, but any time you implement, for instance, by Executive order, any kind of procedural change, there are going to be cracks and people are going to slip through it.

And you're going to end up with people profiting.

And, again, I'd just like to echo what Ann said. We had no way of knowing what people were going to do after they left HUD. I don't think it's necessarily wrong for people to leave a profession, come to Washington for 2 or 3 years and then go back to that profession.

If you prohibit that, you're only going to lose more candidates. What are these individuals going to do? Someone whose been a developer all of his or her life comes to HUD, works for 2 years. And then you tell them they can't go back into developing?

That makes no sense. And I don't know what the affirmative answer to that problem would be.

Senator **GRAHAM**. Connie.

Senator **MACK**. Thank you, Bob. I'm not sure really where I want to go at this point. There are just a couple of loose ends, I guess. The conclusion that I drew from your comments to questions that I had asked, basically, you felt that the end result of the choices that you made with respect to who filled the position were people who were competent.

That, in fact, you felt that, in a sense, you were kind of a protection to the administration in the sense of trying to make sure we got competent people as opposed to people who just were filling a position because they were somebody's political crony.

And that you share I think most people's feeling that if an individual was merely coming to Washington to improve the résumé for the purpose of enhancing themselves, that that was not something you were interested in.

In fact, what it sounded like was if you saw that was the major motivation, that they were down on the bottom of the list.

Mr. **ROBBINS**. And, in fact, Senator, that did happen. I remember sitting in on a couple of interviews and conducting interviews. And one of the general questions is, you know:

Why do you want to come to Washington?

Especially if this were someone from Florida or California, who would have to take a great deal of effort to pack up and move here.

And, you know, occasionally, much to my surprise, you'd assume people were a little more sophisticated than this, you would get the answer:

"Well, I figure that, at my age, it would be a good career move, and then I can leave in 2 years."

Well, you know, that person was immediately axed. And they got a very nice note about a week later that just said, well, you know, we'll keep you in mind. And that was it.

And you're right. Those were people we tried to stay away from.

Mr. **DUTCHER**. I think, consciously, we avoided people like that, at least I did specifically, and certainly tried to, look often for the person who might not necessarily want to come to Washington and contribute to their government, or hadn't thought about it before.

We would call them or we'd get a line on somebody who—I can't say that specifically at HUD, but in other instances, HHS comes to mind—they had been politically active once in their life. But they certainly were what we were looking for. And they had expertise.

We sought them out and tried to convince them that they really should leave their practice and come to Washington and take up this burden, at least for a couple of years, and serve the President and serve the country.

For the people who would make the mistake in the interview process of just saying they were coming to build their résumé, well, that was the last we often heard of them.

Mr. ROBBINS. Or that's the last they heard of us.

Senator MACK. I also got the—I lost that particular thought, but it would be interesting maybe to hear from the two of you, and if you want to elaborate on what you had said earlier, the feeling that it is becoming more difficult to find the right person for the job, that we have made it so difficult that who wants to come?

Ms. BANNING. Well, I can really talk to that because the first year that I was brought to Personnel, I was brought specifically to do a recruiting function for all the different agencies, and particularly technical jobs.

For example, I worked to fund the head of Acquisitions for the Defense Department. And I worked on the IRS job and the NASA job, and some other ones.

And you'd be amazed at how few people you can garner any interest in coming to Washington.

Senator MACK. And why is that?

Ms. BANNING. Well, because of what Mark said. The moving to Washington, stopping their career. If you want the top person, for example, to come, typically, I would say the most senior, most appropriate person might be in their late forties or early fifties. And they have three kids in college.

And they cannot come and make $80,000. And they cannot put all their money in a blind trust. And they don't feel like having, you know, the exposure that they would have to have and the scrutiny, and often unfair scrutiny.

And it is hard to attract those people to Government.

Senator MACK. Let me—the conclusion that one could draw very easily, and maybe it is the right conclusion, is that, as a result of that, then we really don't have qualified people?

Ms. BANNING. If you think—or I do not feel that we have the creme de la creme running the Government. I mean——

Senator MACK. Can we quote you on that?

I was just kidding.

Ms. BANNING. Well, let's talk, Senator. [Laughter.]

Senator GRAHAM. We just did. [Laughter.]

Ms. BANNING. No, I feel that it's very hard to get the cream of the crop because they're at an age level that is very high. I did significant recruiting. I think one of my favorite recruiting efforts was to get the Vice President of Acquisitions for the Defense Department. And there was a guy who I think we got the top guy in America to do the job.

But I think that that is the exception. I think, in general, the public does not want to come work for the Government.

Senator **Mack**. Anybody want to——

Mr. **Dutcher**. Oftentimes, at that point they certainly fulfilled the competence category, and then you have to stress to them the commitment side and say: "You really believe in what the President's trying to do. Won't you come and sacrifice with us?"

And, often, that was the line that you would have to put to this person: Leave your medical practice; come expose yourself to all of this wonder and take your lumps and your Washington Post articles, and those kinds of things; with three kids in college, somehow you can borrow some money and see your way through—and sacrifice.

In many cases, that's what we're talking about, sacrifice. But, that doesn't mean that there aren't bright, shining stars out there, people who, for whatever reason, come and want to do this.

I think we were fortunate in many instances that there were people who wanted to come to Government, and they were the creme de la creme at that particular time period who could come and contribute something.

Senator **Mack**. One of the points that—I don't remember which one of you made it at this point, but one of the points that was made really backs up some of the earlier testimony that we've heard about the importance of the Secretary. And I gather from what you have said that, depending on the perception probably of the Secretary, you would have a lot more interest in a particular agency in comparing who the head of that agency was.

And I guess it not only has to do with the kind of people who might be interested in coming to work in HUD or Defense or wherever, but also how the particular office happens to be managed.

So, I really don't have any further questions.

Senator **Graham**. I'd like to now turn and look inside HUD.

Who at HUD did you primarily deal with on personnel issues? Was there a person during the time that you were there who was your principal contact?

Ms. **Banning**. Debra Dean.

Senator **Graham**. Debra Dean?

Mr. **Dutcher**. She took herself out of that position during my tenure; I dealt with Starr Eckhart, who was the Secretary's assistant. We sent paper through her.

Mr. **Robbins**. And there was a woman on a daily basis that we dealt with named Stephanie Lynch, who was a junior member of the Secretary's personal staff. She was political, but she was the individual that I dealt with on a daily basis with regard to just the paperwork of getting appointments through. I don't know what role.

Mr. **Dutcher**. Then when Under Secretary Covitz got there, I dealt with him, sometimes out of a sense of frustration. I couldn't get through to the Secretary. But, that's who we dealt with.

Ms. **Banning**. Well, I would say our exposure to the Secretary was very limited. In fact, I met him on my last day at the White House.

Senator **Graham**. And how long were you in the position that you held?

Ms. Banning. A year, in that position where I would have been dealing with HUD.

Senator Graham. So, for a year, you were the most direct link between the White House and the Department for purposes of Presidential appointments, and you did not meet the Secretary until the end of that period?

Ms. Banning. I think Bob Tuttle was more involved, and I'm sure he talked to the Secretary. But, I hadn't met the Secretary until I was leaving.

Mr. Dutcher. It was Anne's last day and my first day when I met Secretary Pierce. I had already been in the Office of Presidential Personnel and picked up that portion of the assignment. That was the only time I met the Secretary, on the same day that Anne was there.

Senator Graham. There's been some speculation that there was a desire within HUD to keep certain political positions vacant. Did you ever sense that there was such an affirmative disinclination to fill available positions?

Mr. Dutcher. In relation to other agencies, I can honestly say that it was my opinion that it took longer at HUD.

Now, for whatever reason they may have had, I don't have any personal knowledge that they slowed it down on purpose. But it just took forever in comparison to the other agencies we dealt with on a daily basis. Of course, now we're dealing with 20/20 hindsight and you read about all these things and know about all these things, and you just sort of wonder:

Well, is that the reason that those jobs were left vacant? That if there's not somebody there and people can be assigned to carry out those duties on an ad hoc basis, is it easier than just to leave the positions vacant, for whatever reasons those sitting at the top of that agency may have?

That's only speculation. I don't have any personal knowledge of that. But it was a feeling.

Mr. Robbins. There was one position that, and, again, this is hearsay, but it had come down that the Secretary was not interested in filling, and that was Assistant Secretary for Public Affairs. And what was related to us was the fact that the Secretary didn't believe that position warranted a Presidentially appointed, Senate-confirmed individual. And there were competent individuals running that office anyway making SES salaries, I believe. And he felt comfortable with them doing the job.

I don't know. That's one of those asterisks that every time OPM and the House Civil Service Committee did a report, you know, they would claim that as an affirmatively unfilled position for whatever diabolical reasons when, in fact, the Secretary just plain old didn't want an Assistant Secretary.

Mr. Dutcher. But, as I understand that particular position, Chairman Proxmire at that time had a conversation with the White House about the fact that there was no reason to fill that at the Assistant Secretary level, and they didn't. That was my knowledge of the situation.

Ms. Banning. I agree with what the . . . said.

Senator GRAHAM. You cited a specific situation that may have related to that one position. What would have been motivations on a more general basis to have left positions vacant?

Mr. DUTCHER. Well, I'd say you have a general disagreement among possible candidates. If the Secretary or others at HUD are pushing a particular candidate for a certain position, especially at the PAS level, and for whatever reason we didn't feel that he or she was somebody we would want to recommend to the President, you got into sort of loggerheads here of who was going to blink first. And operating under our constraints of having to obtain the Secretary's concurrence, it was easy, if that concurrence was withheld, to make sure that an individual was not going to be recommended to the President.

That doesn't mean this decision couldn't have been overridden and in fact it might have been. I don't have any knowledge of that. But, certainly, in thinking back, I know there were candidates who we wanted and candidates proposed by others. This would all have to be sorted out at the Secretary's level often between Bob Tuttle and the Secretary.

Those kinds of things would be fought out over a period of months.

Mr. ROBBINS. That method was particularly effective if the Secretary's candidate happened to be someone within the line authority that the duties of that Assistant Secretary job would naturally fall to.

So, that if you had a general Deputy Assistant Secretary who was the Secretary's candidate for position and we either had a concern or had someone we thought was better, by merely withholding concurrence, the Secretary would, in fact, allow his candidate to conduct the duties of that job. The individual wouldn't have the title. But, they would have the purse strings. They would have the signing authority, and they'd have the profile of that position.

Senator GRAHAM. I understand that, at one point, an Assistant Secretary in HUD inquired of you as to whether your office could terminate personnel within the agency.

Could you give us some background as to (a) what was the circumstance of that request; (b) what was your answer to the question?

Mr. DUTCHER. I don't know who we're talking about. [Laughter.]

Mr. ROBBINS. I believe the situation you're talking about, Senator, was when a newly confirmed Assistant Secretary came in to office, that individual wanted to bring on some individuals under him, some—I don't remember if they were schedule C's, or if they were SES's. But he was having problems with the Secretary's personal staff in getting his individuals through. And he came to us to find out exactly what it was that he could do.

But we weren't in the job of firing people. I mean, we didn't know these people on a personal basis. Usually, the only thing we did, we requested notification if people were going to be fired just so that we could let the Secretary know that: Look, if you're going to fire this individual, make sure you've got cause because Senator Graham or Senator Mack has expressed interest in supporting this individual and they, no doubt, are going to want to know if this action is warranted.

So that was, you know, we were there as sort of a weather vein to let them know what kind of storm they could expect.

But we never—I don't recall ever telling someone they couldn't be fired.

Our comments back to that assistant secretary were:

"That's your ball game. If you are going to fire someone, let us know who and we will let you know the backgrounds of these individuals."

But that's something that wasn't in our job description. And it's a function we weren't too anxious to pick up.

Mr. **Dutcher**. And at the PAS level, the Secretary doesn't have the authority to dismiss a Presidential appointee. Only the President has that authority.

Senator **Graham**. Who was the individual that made that request?

Mr. **Robbins**. As I recall, it was Tom Demery, right after he had been sworn in as Assistant Secretary for Housing, Federal Housing Commissioner. And he had had—Tom had a very strong personality. And, you know, the rumors were he was having problems with the Secretary's personal staff in getting anything done. And rightly or wrongly, I suppose he saw the people that he inherited as support staff as being eyes and ears of the Secretary's personal staff and he was anxious to set up his own team and hit the ground running.

Anyway, I don't know if you can blame him. I suppose everyone wants to have their own team in place. Senators don't inherit their predecessor's staffs; they bring in their own people. But there are political realities here and you can't just, you know, if we are looking for people who are competent and committed to the President's agenda, then the fact that they happen to be committed to that agenda through a predecessor shouldn't really affect their job performance.

So you have to balance those. You have to recognize an Assistant Secretary's need to work with people he or she feels comfortable with, along with the fact that you've got people who are also equally supportive of the President, to whom you owe at least fair warning that, you know, they might be in danger of losing their job.

But, I think we handled it the way we handled every situation like that, which was to tell the Assistant Secretary that he would have to come to some form of agreement with the Secretary's staff because we couldn't override them in that.

Senator **Mack**. Yes. The comment with respect to meeting the Secretary on the last day prior, or your last day at the White House, I guess I'm not surprised from the standpoint of Secretary Pierce that I'm not sure he had a great deal of contact with a lot of people in the 8 years he was in Washington.

But, I guess my question really is how important was it for, let's say, you all to have direct contact with the Secretary?

Mr. **Dutcher**. It made our jobs much easier because you could instantaneously get the Secretary's feeling on a particular job, what he or she was looking for and the scope of that office, how they were going to interact. You didn't have to wait for it to come through 16 people.

Numerous times in my other departments, the Secretary would pick up the phone and say, "This is what I want;" and it certainly helped in the search to know exactly what the Secretary wanted because this would be the person 9 out of 10 times who was going to get the job, especially as you moved toward the later stages of the administration.

Ms. **Banning**. I think the involvement of the Secretary just expedites the whole process.

Senator **Mack**. Now are we talking about—excuse me for interrupting, but are we talking about, again, the upper, the ones that are to be appointed by the President and to be confirmed by the Senate?

Mr. **Dutcher**. Yes. And some below that, but not many. Primarily, those people.

Senator **Mack**. Excuse me.

Ms. **Banning**. I think that when we had exposure to the chiefs of staff and they had immediate access to the Secretary or the Secretary's involvement, we could all sit down and just get the job done. We could talk about the jobs:

Whose right, here's their background. It seems like they would be competent for the job. How do you feel about him? Well, I'm not sure that their background has enough, you know, of this or that, or management, or something.

You just got the job done. You were able to leave the office and say, OK, we'll move ahead with these candidates and these recommendations.

Senator **Mack**. So, the normal course of events in dealing with the other agencies would be that you'd find yourself sitting down with the Secretary talking about these particular positions. You would get a feel from them about how important it was to fill this position before another position and get that individual's feeling about their desires as to the kind of person that they wanted. And so there really was a dialog then that was developed between your office—you, in particular, you, personally—and, in most cases, with the Secretary for these upper level jobs?

Ms. **Banning**. I wouldn't say in most cases with the Secretary. I would say that there was a lot of exposure, like, for example, I would be face to face with Under Secretary Newman a lot. And, in fact——

Mr. **Dutcher**. At HHS.

Ms. **Banning**. At HHS, for example.

Or, at Labor with the—what was his title, Deputy? Anyway——

Mr. **Dutcher**. Deputy Secretary.

Ms. **Banning**. Deputy Secretary.

Mr. **Dutcher**. The number two jobs.

Ms. **Banning**. Dave Demerest. And it was clear that they had been very active with the Secretary and that type of thing. And, occasionally, Bill Brock would call me at Labor. I don't want to mislead you to think that I just had daily chats with the Secretaries, because I did not.

Senator **Mack**. But it sounds like though that maybe in those other cases, where you were not dealing with the Secretary, there was a sense that the individual that you were talking to, in essence, was really speaking for the Secretary. You really didn't have any hesitancy about what that person was saying to you?

Is that it?

Ms. **BANNING**. Yes, I'd say that's correct.

Senator **MACK**. And I think you mentioned that you dealt with Debra Dean and who——

Mr. **ROBBINS**. That was a problem once Debra left.

Mr. **DUTCHER**. Once Debra left, there was no conduit into the Secretary and things came——

Senator **MACK**. But, when Debra Dean was there, you felt that she, in fact, was speaking for——

Mr. **ROBBINS**. That's right.

Senator **MACK**. OK. So, where did the problem really come then? I mean, I guess maybe you already answered. That is, when Debra Dean left, you weren't sure about who was speaking for the Secretary, if anybody really was.

Mr. **ROBBINS**. I remember at one point, after Ms. Dean had left her position, being so frustrated that I prepared a memo to go to Bob Tuttle just saying:

Look, we're not getting anything done.

And I wasn't even dealing particularly with the important PAS positions. I just had papers stacking up on my desk with schedule C's and SES's. So I wrote this. I was real proud of myself. I had written this memo suggesting that we go through Under Secretary Covitz, who was someone that we all knew and admired, someone who appeared to have access to the Secretary and someone who had an interest in personnel.

And it wasn't all that odd a suggestion because in most of the other Departments, we had working relationships with the No. 2 job.

So I suggested to Bob Tuttle that perhaps he should suggest to the Secretary that Under Secretary Covitz be delegated the personnel responsibilities. And I think we all knew that that was sort of a pipedream because Bob may have raised it with Secretary Pierce.

But, the comments back on my memo were "Good luck."

So—but that was out of frustration after Debra left. We didn't, you know, there was no one to deal with.

Mr. **DUTCHER**. And in Mark's case, when he's moving paper, when you're hiring people and you have all these packets of things that have to be signed officially, and I can see the frustration. It's, you know, who do you call?

And once Debra left, there really wasn't anybody to call. We turned to Under Secretary Covitz because he at least was up there.

What his relationship to the Secretary was, we can all speculate, 20/20 hindsight. But he was somebody to call.

In our other agencies, we didn't have that problem. We knew who to call. They called us. At HHS, Under Secretary Newman and I met every month and went all the way down the list of positions. If necessary, we would meet with Secretary Bowen. He made time to see us. If it was at the PAS level, the Secretary was certainly involved because we would hear from him. We would often go over there. Bob and I would both go over and meet at times with the Under Secretary and the Secretary.

That was the case in almost 98 percent of the other departments and agencies I was involved in.

Mr. **Robbins**. Interestingly, you know, Secretary Bowen and Don Newman were brought on board sometime in 1985, when most of us were either at Presidential personnel or it was our immediate predecessor, so these individuals were still, you know, when you go out and you hunt for an individual and you bring that individual to Washington and you shepherd them through the confirmation process, they don't deal with you on a day to day basis any more, but they're grateful to you. They see you as someone who has given them a good opportunity.

And I think, with Secretary Pierce, having been there from day one, long before any of us joined the administration, he wasn't beholden to us. He had no working relationship with us. You know, if he saw us at all, it was perhaps as a hinderance or a nuisance, people who were blocking his hand-picked choices for certain jobs.

With Dr. Bowen and his people, they were particularly good to work with because I, at least, was on board when they came through the pipeline. And the people that they had hired were people that we had worked together to get.

And so we had a good working relationship. These people all knew what our jobs were because they had come through that process.

Senator **Mack**. I just have one further question. It really is as a result of what you just said. Blocking his political choices for certain jobs, how often did that occur?

I mean, was that something that you all were just in constant conflict with the Secretary?

Mr. **Robbins**. It didn't come up that much. There really weren't—until the last year, there really weren't, you know, there was an occasional vacancy, but I don't recall there being all that many, you know, balls and you were juggling vacant positions and constantly saying no to the Secretary.

Ms. **Banning**. How do we know it was the Secretary? You know, there was such a lack of communication between the Department and the White House, or at least PPO, that how do you know what you're blocking except by inaction?

Senator **Graham**. You mentioned that while Ms. Dean was there, that she was the effective gate keeper for personnel-related matters.

Is that an accurate characterization?

In previous hearings, there's been some suggestions that she may have used that control in order to place persons that were personally close to her or who would be subsequently responsive to her desires in positions of responsibility.

Do you have any sense as to the accuracy of that suggestion?

Mr. **Dutcher**. In watching the hearings in the other body on some of the stuff that went on at HUD, it certainly made you ask, was she doing all this? Did I know that she was doing all this?

I can't say that consciously I realized that she was doing this because I was focusing on one job, and certainly not at the level that she may have been doing some of these things.

There tended to be people who worked directly for her, as I understand it.

Mr. **Robbins**. And a lot of my understanding through a quick reading of some of the nexus search articles on this, you know, I don't know exactly what she did to place her people in particular jobs.

We found, and this isn't specific to HUD, but in general, once an individual was hired, a political individual was hired, especially at the schedule C level and perhaps junior SES level, their job duties could be changed around.

You know, there were some rules and regulations that OPM had that you had to follow. But, if someone was hired as a special assistant to the Assistant Secretary, their job duties could change. And that didn't have to come through us. That's something we didn't really pay attention to. It wasn't in our line of authority to monitor.

And so, you know, you'd find out that someone who had been hired as a Special Assistant was, all of a sudden, an acting DAS at some point.

If Debra Dean were placing her people around like that, we wouldn't have been in any position to know it.

Mr. **Dutcher**. They didn't have to come back through us. So, once they were there, if they were hired, as he said, as Special Assistant, and then, suddenly, they're becoming the General Deputy Assistant or whatever, unless it was at that PAS level, it wouldn't have to come back to the White House to get an OK.

So, we weren't involved in that.

Ms. **Banning**. I would also say that, to my knowledge, if that's true, I was not aware that that was going on. I will say that she was the gate keeper to what was going on as far as, you know, whose coming in or who we're waiting on or who we're doing—to that involvement.

But, that she would be placing her pals or conduits to other things in the Department, I had no personal knowledge of that.

Senator **Graham**. So you are not aware of any instances that, at the time, appeared to you or subsequently appeared to you to have been abuses of her authority over personnel in HUD?

Mr. **Dutcher**. Certainly not at the PAS level. I can't think of any at the lower levels that I specifically, have knowledge that she was involved with putting there.

Mr. **Robbins**. It was obvious who was in and who was out with Debra Dean because it was easier to deal with those that were in when they also had personnel dealings.

But, I don't think, I mean, that's after the fact. You just sort of——

Senator **Graham**. Could you elaborate on that?

Mr. **Robbins**. Well, if you have—Debra Dean had her staff. Or, it wasn't her staff. It was the Secretary's staff all within the Office of the Secretary. And I really don't know Debra's background all that much, where these people may have met or how they knew each other. I don't know if they were people that were brought on and then worked well with her in her position and they became friends and allies, so to speak, or if they were people that somehow she managed to manuever through the process of getting hired. I don't know about that.

But, when someone had—and lost favor sounds rather, I don't know, it's the wrong term. But, if Debra Dean was not getting along with someone, you knew it. And that goes back to the case I told you about with Assistant Secretary, Tom Demery. You know, if she was having some kind of either policy or personal dispute, it just became a nightmare and it threw us in the middle. And that's how we could tell who was in and who was out with her.

Senator GRAHAM. I've got one more specific question. And then I would ask to ask a general concluding question.

At a House Committee hearing, a former Associate Director for OMB testified that she was active in the selection of HUD political appointees.

Could you tell us how the Associate Director of OMB is linked to HUD's personnel process?

Ms. BANNING. I guess I could do that one.

On several instances, for various jobs, I would consult with some of the Associate Directors at OMB about what they saw as the issues in connection to that particular job. And we would have a long discussion on that. And, occasionally, some recommendations would come down. Or I would run some names of people that might have been suggested for the job by these people.

So, to that degree, they were involved. But, I would say, as far as any—from a recommendation standpoint, perhaps they were involved. But, I would say, from a hiring standpoint, there was no involvement.

Mr. ROBBINS. There was a policy at one point and, again, it was trying to coordinate internally at the White House, that general counsels were to go through the President's counsel's office for cursory review.

And most Departments have either an Assistant Secretary or a Deputy Under Secretary in charge of Management, Administration, Budget.

Those individuals were formerly run by either the Director of OMB, Jim Miller—during most of the time I was there, David Stockman or Jim Miller, or at least their Associate Director for that department.

That was both a practical thing to do, because these were the people they were going to be dealing with on a daily basis, you wanted a working relationship. I think it was probably even as important as a courtesy. It let internal offices at the White House know that we valued and needed their opinion.

As both of you have mentioned earlier, we aren't experts in some of these areas. So we have to depend on the advice of those that are.

Ms. BANNING. I even think, on occasion, they interviewed some people. It wasn't a regular practice. But, on occasion, candidates were interviewed by OMB.

Senator GRAHAM. Were there any instances in which you felt that OMB's involvement was excessive?

Ms. BANNING. No.

Mr. ROBBINS. No.

Senator GRAHAM. Did you feel, Ms. Banning, you mentioned having had conversations with OMB Assistant Secretaries or similar level positions, that they had an effective insight as to the needs of the Agency? And that that insight was helpful to you in then finding personnel that would help meet an identified need?

Ms. BANNING. I think they were very insightful.

Mr. ROBBINS. Very much so.

Senator GRAHAM. The concluding question I have is, if you have any comments or recommendations based on your experience first on the specific focus of this hearing, which is executive oversight of a Cabinet agency from the specific perspective of Personnel, or more generally if you care; and, second, what will be the topic of a future hearing, and that is congressional oversight of the executive branch.

From your experience, do you have any recommendations of systemic changes that might be considered that would moderate the possibility of occurrences, such as has went on in HUD during the Pierce years?

Ms. BANNING. God, I need to think for a second.

Mr. DUTCHER. Just a general feeling to stress the importance of the involvement of the Office of Presidential Personnel with the Secretary, because that communication is important in making our system work.

Part of that arises from the fact that the Office of Presidential Personnel tends to be, as we talked about earlier, the funnel on which all these various interests focus, not only from the outside world, but also from the legislative branch.

This relationship is the glue that holds it altogether; and, in this case, the glue has come apart somewhere. It's sad that, in looking back now, something wasn't done about it at the time.

Senator MACK. Let me just kind of insert for a second, because I just want a couple of clarifying points.

One, you mentioned, again, the importance of the direct contact with the Secretary.

I would ask you if you would go though so far as to say:

Or someone that the Secretary has designated.

Mr. DUTCHER. Or someone the Secretary has designated.

Senator MACK. And the second point is just to clarify as to when the breakdown occurred from your perspective, now looking back.

Was it at the time when Debra Dean left?

Mr. DUTCHER. As far as the paper flow portion, I'm not so sure it didn't happen earlier.

Ms. BANNING. Yes, I would say that I certainly can't talk to after Debra Dean left because during my year of doing that, she was there the whole time. But, I never——

Senator MACK. But, you still perceive that there was a problem there because you didn't——

Ms. BANNING. Yes. I didn't feel any connection to what was actually going on in the agency. I felt more like I worked for them. And that isn't what I thought would be an effective role.

Mr. DUTCHER. And that role contrasts with our feelings about the other agencies that we were interacting with on a daily basis. It was different, and we knew it was different.

Mr. ROBBINS. You know, to repeat myself I think the key is the Secretary's management style. As I was mentioning on the phone to your staff earlier last week, I do not know how you can cure something like that. As a working rule of thumb, we were always looking for people who were good managers because anyone who was a PAS or an SES has to manage. The job of the political appointees is to manage the career bureaucracy.

But what are management capabilities? There are occasions where you get a very successful CEO in a Fortune 500 company who gets into the bureaucracy and can't manage his or her way out of a paper bag, and yet you can take someone, a Hill staffer, a senior Hill staffer who has never managed an individual in his or her life and they become incredible Assistant Secretaries that can perform well. They heal wounds. They can be active where there is a need to, to go forth and get some policy done.

So I don't know how the legislative branch can address this. Chip said earlier he wasn't sure the system was broken early on. I don't think it is, either. Here you had an awful wedding of misfortune, management style, and opportunists who all sort of met at one place in one department, and it is embarrassing. It is not something I am particularly proud of. But I don't know what we could have done, or what you folks helping us along could have done to prevent this. This is something that is going to happen occasionally. We just need to keep communication open so that it doesn't happen too often, or as little as possible.

Ms. BANNING. I think that to the extent the relationships between Presidential personnel and the Secretary's office could be clarified, I think that would be somewhat helpful. I think right now it is that if you have a very laid back relationship with the Secretary's office, that if they want to play a more aggressive role then you sort of lose out, or if you want to play a more aggressive role, that the balance between the two is a major grey area. I think that that leads to confusion, and I think that that can lead to conflicts, or rather it leads to inefficiency, at best.

Mr. ROBBINS. I do think, however, it would probably be a mistake to try and tinker with legislation to clarify the role of Presidential personnel because that is going to naturally change with the management style of each President. If you legislate contact between the Office of Presidential Personnel and say a personal representative designated by the Secretary, that in and of itself does not assure you anything.

It just means you are going to have someone on paper you can call. It does not mean you are going to get the calls returned. It does not mean your advice is going to be taken. And what it does is it provides a hurdle that you then have to find yourself jumping over if the situation does not fit completely within that anticipated by the House and Senate when they pass that legislation.

Ms. BANNING. I have one more remark on something I said earlier. When we were talking about going out and recruiting people to come in from industry for example to take over these roles, I want to make clear that I in many instances feel that there might be one person, or two people, or whatever in the United States that might be absolutely perfect for these jobs. And in many instances, I don't believe we have those top one or two.

Do I believe that the people are competent? I do. What I was suggesting was that there are so many elements that come in to preclude people from being able to come, that that affects it.

Senator **Graham**. Mr. Robbins, I said that was going to be my last question, but your comment raised another one.

There seemed to be a culture that was operating at HUD, an attitude among people, probably from the Secretary at least down through his immediate staff. You have indicated, each of you, some instances in which maybe you picked up on that. Could you comment as to the degree to which you conveyed what you were sensing to somebody that could do something about it? The President of the United States clearly has a goal of having all of his "children" behave as properly as possible and grow up into high-performing adults. Here we have a crippled child that maybe needed a lot of attention. Could you comment on the process as you saw it that brought that need for special attention to a level that could have then addressed it?

Mr. **Dutcher**. Well, I know I certainly had numerous discussions with Bob Tuttle about that. I also had discussions with Associate Directors at OMB. And normally the response back would be, they were just as frustrated about the place as we were. So——

Senator **Graham**. If the President of the United States cannot control a Presidential agency, who can control it——

Mr. **Dutcher**. Exactly.

Senator **Graham** [continuing]. A Presidential agency?

Ms. **Banning**. I guess I just do not feel privy to know of conversations that took place in that regard. I know that we had brought them up to Bob, and I would imagine that Bob would have brought them up to other people because it——

Mr. **Dutcher**. It was his style.

Ms. **Banning** [continuing]. It was a big deal, and Bob did not keep things from his predecessors, from what I have seen. But do I have any general knowledge of those discussions? I really don't.

Senator **Graham**. Thank you, very much. We appreciate your very helpful historical and sociological insights.

Ms. **Banning**. Thanks.

Mr. **Dutcher**. Thank you, Senator.

Mr. **Robbins**. Thank you, Senator.

Senator **Graham**. If the members of the second panel would please come forward.

Since January this subcommittee has held hearings on a number of topics. We have examined specific HUD programs such as coinsurance. We have examined HUD's management controls. And most recently we have heard testimony on HUD staffing. In every area we have examined, with the possible exception of one hearing which looked specifically at how housing deals were put together, the involvement of OMB has entered the discussion. And we have just added another chapter of that OMB involvement when discussing the appointment of political appointees at HUD.

With the remaining two panels we intend to explore the role of the Office of Management and Budget in overseeing HUD. We hope to obtain some insight into how HUD was influenced by OMB during the Pierce administration, and equally as important, how OMB might influence HUD during the present administration and future administrations.

Previous congressional hearings on OMB's influence at HUD during the 1980's has been limited to testimony by Carol Crawford, a former high-level political appointee at OMB. Frankly, Crawford has been unable to provide details.

During the course of our subcommittee's investigation, we quickly discovered that the lower level career people at OMB, such as budget examiners, were able to provide much more detail as to how OMB influenced HUD in the past. OMB has been cooperative and has allowed us to interview veteran career officials. Unfortunately, these knowledgeable career people will not be witnesses at today's hearing. OMB has a longstanding policy of not subjecting its career people to be witnesses at congressional hearings, and we choose to respect that tradition.

However, our next panel, which consists of Mr. William Diefenderfer, the Deputy Director of OMB, and Mr. Frank Hodsoll, who currently heads OMB's Management side, are here today to discuss the past as well as the future. I will mention that Mr. Diefenderfer has promised this subcommittee that he would appear for today's hearing fully briefed by the career individuals selected by our subcommittee, all of whom worked at OMB during the Reagan Presidency and all of whom dealt with HUD. Those career staffers will accompany Mr. Diefenderfer and will assist him in answering our questions when that is necessary.

I appreciate your joining us today and, as we did with the first panel, I would ask you to rise and raise your right hand.

[Panel sworn.]

STATEMENT OF WILLIAM DIEFENDERFER, DEPUTY DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Senator GRAHAM. Mr. Diefenderfer, Mr. Hodsoll, do you have an opening statement?

Mr. DIEFENDERFER. Yes, sir, I do.

First of all I want to thank you and Senator Mack for inviting us to testify.

Second, I want to thank you for being so accommodating to OMB in terms of our rules concerning the testimony of career staff. Everything is as you said it was.

Third, I want to thank you for having hearings of this nature. I have been an advocate before this committee and others that congressional oversight of this sort be conducted at the subcommittee level governmentwide.

I am here to discuss OMB's role in overseeing the budget and management functions of the Department of Housing and Urban Development, and our plans for oversight of executive branch management.

We did not adequately address HUD's problems until they became highly visible in 1989. No one took the necessary actions, even though many of the problems were known within HUD and at OMB much earlier. Why wasn't the oversight process effective?

To answer, let me address the past budget and management oversight, particularly with regard to HUD, and detail current efforts and plans to improve OMB's management oversight responsibilities.

PAST OMB BUDGET/MANAGEMENT OVERSIGHT OF HUD

OMB's review of HUD's budget and programs is handled primarily in one budget branch of five or six examiners. That is presently. I think during the period between 1982 and 1988 it was about four, or four-and-a-half on average people in that branch.

This is a heavy work load for five or six people. The staff can deal with aggregate program data and address major budget policy issues, but not much more. During the period in question, I believe the budget staff in fact did this.

It should be noted that the budget examiners did not scrutinize HUD below this aggregate, and that they had very limited capability for doing so. At the same time, OMB did not do as good a job as it should have in terms of management oversight.

The management staff, as I have testified previously, was reduced from 224 in 1970 to 47 when Mr. Darman and I came to the Office of Management and Budget in 1989. Less than half of the 47 were devoted to financial systems and credit and cash management. The bottom line was: insufficient OMB staff to monitor HUD activity.

To give you an idea, just one management analyst was assigned to review all agency reports submitted under the Federal Managers' Financial Integrity Act, FMFIA, as it is frequently called. Although HUD reported planned corrective actions for problems in their annual FMFIA submissions, they often did not take the corrective actions promised. While we have allocated in our new regime 10 employees to management integrity and internal control activities and issues, the ultimate responsibility for the integrity of HUD's programs lie with HUD.

I might mention that Congress was very responsive to us. When we asked for 50 new employees to address some of the problems we were experiencing in management, we were given that and have begun to staff in that area.

Senator **Graham**. Excuse me. Could I just ask, looking historically, how did the numbers of staff that OMB had during the Pierce years coincide with what had been requested in the President's budget?

Mr. **Diefenderfer**. They pretty much reflected the request in the President's budget. There was a deemphasis from—well, starting, to be fair, it wasn't all President Reagan's. There was a deemphasis on the management side of OMB starting in the middle to the late 1970's that continued through the late 1980's. Congress was not responsible for cutting back on the number of people requested for the management side.

That said, OMB has never been, and at that particular time was certainly not the darling of Congress, and there were fights about money and what adequate funding would be for OMB. But they were not fought over in the management areas, so I do not think that can be attributed to the action of Congress.

Senator **Graham**. Thank you.

ACTIONS TAKEN SPECIFIC TO HUD

Mr. **Diefenderfer**. In the area of budget resources, these are actions taken specific to HUD. The administration is requesting in fiscal year 1991 $23.7 billion in budget authority, an increase of $5.3 billion over this year. Funding is included for renewal of all expiring housing subsidies, and for the administration's HOPE initiative. Also included are funds for an additional 725 staff years over fiscal year 1990. That is—particularly the staff year funding and the increase in funding are some things you would not have found when HUD needs were not being properly addressed in the 1980's.

In addition, funds have been requested to improve the financial management systems of the Department, which is essential. Improved financial systems should improve our ability to get timely and dependable data to manage the reforms we have initiated.

Some of the reforms we have initiated with the Congress' help are contained in H.R. 1 which has been enacted and signed by the President.

The most notable reforms are:

Precluding investors from participating in the FHA programs so that it serves primarily first-time and moderate-income home buyers. This reform was first proposed by OMB in its 1983 passback to HUD, and was included as part of the President's 1987 budget;

Prohibiting advance disclosure of funding decisions by HUD employees and requiring HUD to publish all funding decisions once finalized;

Requiring registration and disclosure of fees by consultants lobbying HUD; and

Establishing a chief financial officer and an FHA comptroller.

The development of rules to implement these changes is among the Department's highest priorities. We are getting extremely good cooperation from the highest levels in HUD in addressing these problems from the Secretary himself, who we have no difficulty getting access to, and his Under Secretary, Al DelliBovi.

The development of rules to implement these changes is among the Department's priorities, as I said. HUD will soon name an acting CFO, and has just completed selection of an FHA Comptroller with an announcement to be made shortly. As HUD's Deputy Secretary, Al DelliBovi, testified last week, top management attention is now being given to internal controls.

A new tracking system has been developed and review areas have been consolidated. Each high-risk area will be reviewed in the next 3 years, and corrective action plans must be submitted to the Deputy Secretary within 30 days of a material weakness being identified.

You should also know that HUD has undertaken a number of reforms in connection with the FHA Coinsurance Program which was responsible for nearly $1 billion in FHA losses. These include stiffer underwriting and higher capital reserve requirements on the part of the coinsurance lenders. As HUD Deputy Assistant Secretary Peter Monroe testified last September, HUD suspended acceptance of new applications for approval of coinsuring lenders pending an evaluation of the program. It has suspended a number of the lenders who were in the program, placed others on probation, and is closely monitoring others.

CURRENT OMB MANAGEMENT INTEGRITY PROGRAM

Three principles are guiding OMB's oversight of Federal management integrity. Sound management is the responsibility of the very highest policy and program officials in the agencies. You have heard me testify before that the President has met with the Cabinet indicating the importance of their attention, personal attention to management integrity activities.

The Director has met with the Deputy Secretaries, and today by coincidence the President had all the deputies of all the Departments in to lunch in the Cabinet room to talk about the administration's commitment to management once again. So we are getting the high-level attention we need from an OMB perspective to address these problems.

OMB recently established a management integrity branch to put these principles into practice. Last week Susan Gaffney, formerly Deputy IG at GSA, joined our staff to lead this branch. This is part of the staffing up I referred to when I was previously discussing increasing the staff on the management side.

She brings exceptional skills and experience to the task at hand. She works for Mr. Hodsoll. In addition to creating this new branch, we have assigned primary management oversight responsibility for each major agency to financial management staff division members. The management component of OMB will continue to work on cross-cutting issues, but the assignment of management examiners for specific agencies should, working with the budget examiners, the budget side, provide the needed help of conducting Federal management oversight.

We have developed a high risk list which I talked about when I was before this committee before of over 100 major problems in areas of government, and to give these areas priority so that we can prevent the loss or misuse of Federal assets. The list is currently under revision based on our analysis of the 1989 FMFIA reports. Agencies are responsible for correcting weaknesses and OMB is monitoring progress.

We have provided significant increases in budget resources for inspectors generals and for improved financial management systems, internal controls, and credit management. And this is a departure from past activity within OMB. Director Darman has said that our OMB, when we sit down to prepare the President's budget, will have the budget people on one side of the table, and for the first time we will introduce the management, and we have done this in preparation of the 1991 budget. And they were very successful this year. We have some of the areas stressed in our budget where we made particular efforts to back up our commitment with funds.

FUTURE PLANS FOR OMB MANAGEMENT OVERSIGHT

OMB and the agencies are pursuing corrections of those items on the high risk list. OMB will make needed changes in the FMFIA process to ensure that the agencies focus on program management as well as administrative management.

We need a change in culture. This is not an easy thing to get people to do. To say to people: Tell us what is wrong. Tell us what you are doing wrong. It is counterintuitive. In the past, when they identified things that were going wrong in their departments, they were punished. Our message to them now is: You will be rewarded for identifying problems. The punishment comes if you do not deal with the problems once you have identified them.

I think that is having some measure of success and people are starting to believe us in terms of our commitment.

Additional areas of special emphasis for the administration will be:

Clearer and stronger standards and policies for guaranteed loan programs with particular emphasis on lender certification and agency monitoring of lenders; and

Enhanced financial information on credit programs to ensure that the President and the Congress know the true value and condition of the Government's portfolio, and that there is early warning of emerging problems.

In our budget we have a section that is called "assessing future liabilities of the Government" where we indicate that we have some exposure of $5.8 trillion when you add it all up. It is the first, I think, systematic study of this that has been done and these are the kinds of problems we want to monitor on a daily basis so we don't have the surprises of the S&L's and the unfortunate budget consequences that flow from it.

OMB agrees with GAO that too little progress has been made in strengthening the Government's financial management systems. We also agree that the executive and legislative branches should join together in helping the agencies develop sound internal control and financial management efforts.

For its part, OMB is developing a strategic financial management systems plan to guide the development of agency and governmentwide systems. The plan will also provide for movement toward annual agency financial statements to improve accountability in agencies.

CONCLUSION

In conclusion, OMB is reorienting itself to ensure earlier detection of major management problems. Oversight will be aggressively pursued by both Budget and Management examiners. I believe OMB, working with agency management and inspectors general can build the necessary safeguards to reduce waste, fraud, and abuse, and provide effective stewardship of the public's business.

We need in this effort the support of Congress, and particularly the authorizing and appropriations committees. We thank you, Mr. Chairman, for convening this hearing. We look forward to working with you in the period ahead to secure housing programs in which the public can have confidence.

Thank you, sir.

Senator **GRAHAM**. Thank you, Mr. Diefenderfer.

Mr. Hodsoll, do you have any opening statement?

STATEMENT OF FRANK HODSOLL, EXECUTIVE ASSOCIATE DIRECTOR FOR MANAGEMENT, OFFICE OF MANAGEMENT AND BUDGET

Mr. HODSOLL. I would only add, if I could, three points.

First, management has to be dealt with at a high level and not just by people called "managers." I think that is now happening at HUD.

Second, and particularly at HUD, there need to be information systems and accounting systems to provide us with decent information—to know exactly what is going on with accurate numbers that are ultimately auditable. That is beginning at HUD.

And third, there has to be seriousness of purpose in implementing the Federal Managers Integrity Act which was properly enacted by Congress many years ago. That is, seriousness with respect to ensuring that there really are internal controls, and that there really is audit followup, and that that is taken seriously not just by the managers but by the program people themselves. I think that is also beginning at HUD.

Thank you, Mr. Chairman.

Senator GRAHAM. Thank you, very much.

I am going to be focusing first on history, and then we will focus on the future. Looking back in history in terms of HUD's staffing, on Friday the subcommittee heard testimony about the decline in staffing at HUD over the 1980's and the adverse effect that that was having on HUD's administration of programs and the delivery of housing. The term "brain drain" was used by several to characterize what was occurring.

Was OMB aware of this decline in the managerial competence of HUD during this period?

Mr. DIEFENDERFER. OMB was certainly aware that there was a decline in FTE's at HUD. It was Reagan policy to reduce FTE's governmentwide by about 75,000, and I think the target date was 1984. And at HUD, they started with about 16,000 I believe in the beginning of the administration, and by the end of fiscal year 1984 were down to about 12,600, I believe. OMB was certainly aware of that.

As to OMB's awareness of the loss of skilled managers, I don't think that had been focused on. That normally would have been the job of the management side of OMB, and they were more or less moribund. We had one person looking at the management side for all of Government. So if you divided that person by 70 or so possible FMFIA reports he was looking at, it was a very cursory look indeed and he never would have been able, in my judgment, to get down to whether or not we were losing one, or two, or three, or four exceptional managers at HUD.

Senator GRAHAM. Was anyone aware at OMB that OMB's capacity to oversee the qualitative aspects of management was as limited as you have described it as being?

Mr. DIEFENDERFER. I would think, yes, sir, that they would have had to have been.

Senator GRAHAM. And what conclusion do you draw from awareness of your inability to ascertain whether there is a qualitative decline in management?

Mr. **Diefenderfer**. I conclude—and it is not limited to HUD—I conclude that the previous administration, and perhaps the administrations before that, did not think emphasizing management was a priority task with them, and therefore they did not. I also conclude that is a mistake. Hindsight is my privilege in this case.

Senator **Graham**. Were there any statutory ambiguities in the oversight responsibility of OMB as to the management of HUD or any of the other executive agencies?

Mr. **Diefenderfer**. No, I do not believe there are any statutory ambiguities, no, sir. OMB is part of the Executive Office of the President. The President has a large amount of authority to oversee his departments, and that is delegated to OMB.

It basically comes down to two things. One is what emphasis any particular President puts on that type of function. And second, I believe the second most important thing is the interest and the quality of the OMB Director who occupies the office at any point in time.

Senator **Graham**. There seems to be a schizophrenic quality. We heard from panel one that there were some fairly extensive contacts between the Presidential Personnel staff and OMB relative to personnel, and Ms. Banning testified that she felt that that involvement was positive in the sense that the OMB people seemed to know a lot about the needs of the agency, and therefore what they had to say about personnel she considered to be a valuable source of additional information. Also, on Friday, Mr. Brian Chapelle mentioned that during his years at HUD, he found OMB to have a very high level of oversight of proposed HUD regulations.

On the other side of the house, it seemed as if there was relatively little information about the sort of macroissues that were going on—the fact that there was a brain drain of quality managerial personnel; and that there was an accumulation of problems that would eventually lead to the debacle with which we are currently confronted.

How do you explain this schizophrenic high participation level with microissues and almost amnesia relative to the big picture?

Mr. **Diefenderfer**. Well, I would say that many of these things are part of the big picture. First of all, in terms of Presidential Personnel talking to OMB about a job that they are going to fill, one of the first questions they ask, [they still call us, and I am sure we will call our successors years hence,]: What are the major policy issues that are being pursued at the ICC, or the FCC? What are the President's major objectives?

Then we will—we have those, and we will list them for them, and they will use those in questioning and talking with the prospective applicants for those jobs.

Sometimes they will come back and say, well, look, we heard what you told us about the issues that have to be addressed. Now we have identified 4 or 5 people. Do you know them? Do you know if they can address these issues?

But in the period of time you are talking about, as I testified, there was a very small emphasis on the management activities in the Department. The major emphasis was placed on regulations and the program activities, and these were the people they were talking to. When you mentioned it, the other gentleman said, well, there was OMB oversight of regulations and that seemed to be working fairly well. That is absolutely right. That was OIRA, and they were charged with any regulation that moves through the Government. They have to look at it for paperwork burden, for cost effectiveness, and that was a very active and strong part of OMB during the Reagan administration.

So the two areas where they got a lot of feedback were areas that were strong: Policy and regulation. Where they did not get the feedback was on management. What are the management skills necessary for this policy person? Or it may be a pure management job. What do they have to have to carry out the things that we need to get done?

Senator **Graham**. I guess my question is, How can you have a deep interest in policy and not have enough interest to know that your ship is sinking? If your policy is to get to a destination, but the ship is taking water, you are not likely to make it. If you are not aware that your ship is taking water, then you will not take the steps to rectify the situation.

Mr. **Diefenderfer**. You cannot be effective if you do not have a deep interest that cuts across all of those three areas we just talked about. But once again, what you will find is that whoever the leader is will set the tone for what the subordinates find important. If you are interested in four or five different areas, that is what everybody—the best people on your staff want to work on.

Management was not emphasized by OMB, and therefore people ignored that. Now that is not good. It is not proper. It does not allow one to operate as efficiently as one should, but that is what happened.

Senator **Graham**. You mentioned—and now I am going somewhat to the future—the reforms that you have taken. What type of data will you be monitoring in the future, specifically as it relates to HUD, to give you a sense of assurance that the HUD of the future is not like the HUD of the past?

Mr. **Diefenderfer**. Well, we are going to be monitoring data in several different areas, and here I will ask Mr. Hodsoll to assist me, but first we have the high risk areas that we have identified for HUD. We get reports from them quarterly on the progress. They have to give us milestones and timetables for achieving those milestones, and that is an ongoing process.

The same with the MBO's that have been set out for the Secretary, the same milestone and timetable process.

We are moving in the area of financial systems so we can get what we consider to be almost real-time data to evaluate the strength or the weaknesses of our portfolios. As you probably know, in our budget we indicated a worry, a strong worry about the strength of FHA. Secretary Kemp had that similar concern. He had a study conducted by one of the big eight accounting firms which is about to come in, and we are going to pursue that one, obviously, when all the details are before us.

Frank, can you——

Mr. **Hodsoll**. Just to add on a couple of details. Obviously, we will want to monitor carefully the rate of default that is taking place both with respect to direct credit and with respect to guarantees. We will want to have, as Bill was mentioning earlier, a greater degree of certification of lenders, and Secretary Kemp has already taken some actions there, but we will also need—and here the Treasury Department has just produced a draft report on guarantees generally—much better information than we currently have, not only at HUD but in Farmer's Home and a lot of other credit programs, as to exactly how lenders are doing, what is happening in particular real estate markets, et cetera. So we will need what I call leading indicators on those things, and we don't have them now.

Mr. **Diefenderfer**. An example of a leading indicator in FHA, not to pick on them, it is just that I have been doing a little bit of work on them recently, is loan-to-value ratios. Many people believe, and I happen to be one of them, that that foretells the default rate of a portfolio, and we have to have an up-to-date measurement of loan-to-value ratios of that portfolio, and we are trying to pursue a system that will give us that on almost a real-time basis.

Senator **Graham**. I am now returning back to history. We had a hearing last week on FMFIA, the Federal legislation which is intended to give an oversight of financial integrity. It was represented that HUD had deceptively certified in 1987 that its accounting systems were in satisfactory condition, when in fact there was wide knowledge within the Department that the systems were experiencing serious problems.

At the same time, we were led to believe that OMB examiners were concerned about the state of the FHA fund, among other financial responsibilities within HUD.

What action did OMB take when they saw the 1987 certification in terms of the information that they had, or could have had, or should have had to indicate that it was not an accurate reflection of the status within the Department?

Mr. **Hodsoll**. I don't think any action was taken at that time. First of all, the certification was that the systems were OK and we didn't have the staff capability essentially to verify that at that point.

Mr. **Diefenderfer**. I want to make sure that we have the accurate representation of the career staff, also. They reminded me that this was this a seventieth of a person that we were talking about who got the reports, the FMFIA reports, and filed them. There was no critical review of them whatsoever. They were just received and the block was checked that, yes, they filed their report.

Mr. **Hodsoll**. In fact, until this year that is what happened to FMFIA reports. They were simply filed.

Mr. **Diefenderfer**. The feeling was, I think, that the fact that you made people fill out these reports would make them attentive to the needs. We all know that that does not work. If people know you are not really interested in the report, it is make-work for them. They assign their people of least-capability to them. There is no money allocated or attention paid to them by people who have higher levels of authority within the departments. As Frank mentioned, we are trying to redress that, but that was what was done in the past.

Senator **Graham**. What will you be doing in the future in order to be able to pass some reasonable assessment of the accuracy of

FMFIA reports, and to follow up where there are identified weaknesses?

Mr. **Diefenderfer**. We are doing a number of things. First of all, some of the weaknesses that will be identified on FMFIA reports will also be part of the high-risk list which will get special attention.

Second, we have increased the number of people in the area of the management integrity area to 10 from the 1 person we had. In addition, we have developed a coordination where we have the budget side looking at the management issues, as well. So we have both sides looking at each other's responsibilities and commenting on them.

In addition to that, we do some other things which we hope will give us early warnings of things going wrong and not being addressed properly. I serve as Chairman of the President's Council of IG's on Integrity and Efficiency, PCIE. I meet with the IG's once a month and problems of this nature are surfaced. I meet with all the IG's once a year personally for an hour or two to discuss particular problems in their departments, and any time they request of course.

I also meet once a year for an hour or two with all of the deputies, my level, to see what they have to say, and also to criticize them if we feel they have not addressed some of the problems in the FMFIA reports.

I also meet for an hour or more with each of the Assistant Secretaries for Management by myself with my staff, no other people present from the Department asking men to tell us, are you getting enough resources? Are you getting enough attention? What are the problems that you have identified, or that have not been identified recently that have surfaced that you think we ought to pay more attention to? How can we help you?

All these I think will be effective, but it is about the level that OMB can exert in these areas. We have about 500 employees for the whole Government, and we don't have the strength of a GAO for example with 5,000 employees. So ours can be leadership, basically. We can set standards, and every once in awhile we can check through audits periodically and try not to let them know when we are coming.

I can give you a perfect example of that ongoing as we sit here today. The IG from the Railroad Retirement Board came to see me and said we have huge problems at the RRB. I won't even bother to detail the problems for you—a single-spaced sheet of four type-written pages. We analyzed those with him. We put together what I call a little swat team which took people from OMB, took people from IRS, there were some tax problems, took people from HHS, there were some Medicare and Social Security type problems, invited the GAO to participate, we invited the committees on the Hill who have jurisdiction to participate. We went out there and have conducted in the last 2 weeks an onsite review of all of their activities and programs.

We are going to bring the data to OMB, analyze them, and then call that group in for a hearing at OMB and say, here is what we have found. These are the problems. Here is the solutions we suggest. Can we enter into a contract with you? It is not a contract in a legal sense, but we are using a contract format. We have done it with IRS, and the contract says here are your problems. What will you do to correct these problems? What are the time tables? What are the milestones? We want to be able to measure you. We want to see the results.

We can do this on a spot basis. We do not have enough people to do all of government program by program to do this, but we hope that this, whether it is fear, or responsible activity will convince people that we are serious about these things. Those are some examples of things that we are doing.

Senator **Graham**. My colleague has returned. At a previous meeting, Senator Mack had alluded to some of his experience as president of a bank which used an audit committee concept to bring in people who were outside the bank to review the certified public accountant's report or other documents.

Do you think that such an approach might be an idea that could be adapted to the review of internal documents and evaluation of control systems?

Mr. **Diefenderfer**. Well, I think so. The question is, where you get these people and how you pay for them and how you make this a regular function that produces something? Essentially this is what we are doing in the RRB because we are drawing people from outside that particular agency's and outside OMB's domain to come in and offer critical viewpoints.

But once again, we could not do that for every program in Government. I once had advocated, and have not received a whole lot of favorable reaction to it, that industry, business adopt departments or agencies that they themselves do not do business with so there would be no conflict, and that they get the FMFIA reports and analyze them from their manager's point of view, and then provide criticism to the Secretary of what was going on.

These kind of things may be of help. We get GAO reports, I mean GAO is very good at identifying problems. That is their long suit. They don't have a suit when it comes to following up and rectifying the problems. I guess it is not their job.

Mr. **Hodsoll**. If could just add, Mr. Chairman, in the Federal Credit Policy Working Group, which we have as a part of the Economic Policy Council, we are in the process now of starting an effort to look at audited financial statements of all the credit programs, in particular as part of an effort to go toward audited financial statements for agencies themselves.

Indeed, this is presaged in the HUD Reform Act of 1989, specifically for HUD. I think it is our view that if one can force the discipline of having to have auditable information with regard to a number of these things, then that will not only help improve the financial systems which will have to produce that information, but also put a discipline on top leadership and program managers to be thinking about what their program actions are ultimately entailing in terms of contingent liabilities and the like in the future.

Senator **Graham**. Senator Mack.

Senator **Mack**. Thank you, Senator Graham.

I think I want to just kind of start with a fairly broad, general kind of question in the sense of trying to determine what you really believe your role is from the management perspective. How broad is it? Is it broad enough?

I mean, I hear you say on the one hand that you do not have the staff and the resources necessary to cover all agencies. I guess the kind of reaction I have is, well if you don't, who does? So if you could, give me as best you can what you perceive your responsibility to be with respect to whatever management means in OMB.

Mr. **Diefenderfer**. Our responsibility I think, very simply stated, is to help the President have the best-managed Government possible. Our ability to do that, because of our relatively small size, cannot be done on a program-by-program basis. We cannot take every beach so to speak in Government where there is a problem.

That would take, in my judgment, an agency of the size of GAO by a factor of maybe two or three. There you would have the audit capability of going in and auditing every program——

Senator **Mack**. Let me just stop you there for a second. Should we be able to do that?

Mr. **Diefenderfer**. Well, there is no administration policy on that. If you ask me——

Senator **Mack**. I am just really asking you.

Mr. **Diefenderfer**. If you were asking me Bill, if you could wave a magic wand, what would you do? I would like audit capability that is vastly increased over what we presently have. I think we could take easily 300, 400, 500 more people and put them in the area of audit. Now that would not give me the capability, once again, to audit every program every day or every year even, or every 3 or 4 years, but I think it would give me enough people to put a higher level of the fear of God in people who are managing these programs on a daily basis. They would know that OMB is over here, and we heard they are over there, and they are going to come here next, let's make sure we have our ducks in a row.

Now it is a little bit like an IRS audit program where maybe we get in at 1 percent, or ½ a percent, or ¼ of a percent of all the possibilities to look at. Now the Director has never said that, so that is my personal response. I think I could do a much better job if I had a complement of that nature.

Senator **Mack**. Could you identify for me in the business world what department or what function in business would be similar to function of management at OMB?

Mr. **Diefenderfer**. Well, many companies have an assistant, or a vice president for management, a vice president for budget. Some of the activities of vice president for finance are present. Can you think of any others?

Mr. **Hodsoll**. Comptroller of a corporation.

Mr. **Diefenderfer**. That's right. Those are all present. I don't know if I said Assistant Secretary for Policy Development. We have a function there also. And then we also serve as a sort of executive secretary for the corporation that brings it all together.

Senator **Mack**. I think one of the things that comes to my mind, and maybe this is a point that was raised while I was out of the room, and if it is I apologize, but I see we have the IG, we have the General Accounting Office, OMB, there is talk of a Chief Financial Officer, the concept of that. I assume the IG does audits of some form——

Mr. **Diefenderfer**. They do.

Senator **Mack** [continuing]. Within each of these agencies, and I assume there are also other people out there doing other kinds of checks.

Mr. **Diefenderfer**. GAO I would think would be the other significant auditor.

Senator **Mack**. It almost seems like maybe there needs to be a discussion about whether there ought to be a reorganization of how one goes about checking up—because that is what it really comes down to, as I said in one of the previous hearings—people do what you "inspect," not what you "expect."

It seems like we have got a lot of organizations who are somewhat inspection-oriented, but there is no coordination. I am just wondering if there should be some reorganization of how we go about inspecting what in fact is happening "in Government."

Mr. **Diefenderfer**. I think such a review would be more than an academic exercise. I would welcome participating in it. I might say that there is some coordination. The fact that I chair the IG's in Government, and I also chair the Assistant Secretaries for Management, that's one of the things that we are trying to get into harness, and I bring them together. We have joint meetings of them. We share what projects we are working on, our solutions to problems we've met, between the various groups. So that sharing is going on.

As concerns GAO, I was told—I don't know if this is a fact; you best ask them—that about 80 percent of their activities are congressionally directed. Having worked in Congress——

Senator **Mack**. Who are the other 20 percent, by the way?

Mr. **Diefenderfer**. I imagine they are things that they decide they would like to do.

Senator **Mack**. I see.

Mr. **Diefenderfer**. They follow up from their system.

Having worked in Congress as a staff person both on the House side and the Senate side, I was familiar with a lot of the congressional requests and they were not necessarily developed in any organized pattern. A lot of them had less structured reasons behind the inquiry than one would like, if you were going to take 5,000 possible people and put them to auditing in a comprehensive way.

Senator **Mack**. I could draw from that that some of what has been done at GAO is politically oriented, and that is fine. That is going to happen from time to time. But that raises the perspective that one could say, wait a minute, why should we have a large investigative body and inspection organization within the administration, when in fact we have a system that is set up that is politically driven anyway to make sure that Government is doing the right thing? I am really saying that with the Congress and the General Accounting Office, one could claim that with, you used the figure 5,000, I assume that is the number of people at the General Accounting office——

Mr. **Diefenderfer**. I think it is——

Senator **Mack** [continuing]. With 5,000 people who at any moment can swoop into any organization and go through an inspection process, that might in itself be the best way to ensure that there is someone looking over someone's shoulders to make sure that the right things are being done.

Is there any value to that?

Mr. **Diefenderfer**. Well, there is some value, and I didn't mean to say that all the questions from Congress were politically oriented——

Senator **Mack**. I know you didn't. You did not.

Mr. **Diefenderfer** [continuing]. But they may not be best structured in terms of need. What may be very important to one person, if you had to rank order for the good of the Nation that would not come on the list that was going to be examined.

I think that GAO is very good, and others, at swooping down but what we have, we have had people swooping down for the last 20 years. We had the IG's swooping down on HUD in 1983. The problem was, nobody listened and nobody followed up and said: Are you changing your activities to reflect what we have discovered in the 1983 HUD report?

That is not a function of GAO, as I understand it. If I had those extra people I talked to you about, that is where I would put them, is going regularly to where areas have been identified with problems and seeing if we have followed up.

Senator **Mack**. I will get to that follow up in a second, but I wanted to get back to, as I understood from your opening testimony, I think you indicated that there has been over a period of years, starting back in the early 1970's, a kind of retrenchment, if you will, with respect to the responsibilities of the management side of OMB.

What caused that?

Mr. **Diefenderfer**. Well, I think there are a number of causes, and some of these are speculative, but I think I am right.

Managing is, as Director Darman has said, not a sexy thing and was not emphasized from above for as long as we can look back. Political appointees and other people who come to Government, if the bosses don't think it is a sexy thing they are not going to get involved in it and they are not going to take it seriously, and therefore OMB reflected that same attitude. You were right in 1970 that we had about 224 people working the management side. When Mr. Darman and I took office, we had 47 working on the management side. That is No. 1.

No. 2, is that there is something that I call the raison d'etre syndrome. That is when various departments and agencies within departments have a program that becomes their reason for being, and they cannot and will not look critically at it. The last one which I call the "you always hurt the one you love" syndrome was best identified I think in say the defense $400 toilet seats and $1,000 wrench scandal.

What you saw there was the conservatives—I'll call them conservatives who believed in a strong Defense that circled the wagons and said, no, this is not a problem. Let's not look at it, and they tried to divert attention. What they should have been doing is, if you believe in a strong Defense, is constantly inquiring into the activities of the Defense Department to make sure they were pure and above board. Otherwise, you are going to lose public support for one program that you believe in, and that is in fact what happens.

On the liberal side—I call it the liberal side—when we have identified problems of fraud in say VA compensation, food stamps, whatever, we say, look, guys, what we ought to do maybe with student loans is cross-check with the IRS to see if these people are telling us the truth between their tax returns and their loan applications. They say, oh, no, no, we can't be doing that. They had 80 different reasons. One of the reasons—I think President Reagan hit a nerve in that area—is the public knew that there was cheating going on. They knew of examples, and they knew that people that were defending these programs said: Don't worry about it.

So that is the "you always hurt the ones you love" syndrome. These things continue unless from the very highest levels the attitude is changed, and I think the President has done that.

Senator **Mack**. Which raises another question. I think that in response to one of Senator Graham's questions I think you indicated that you did not really see any kind of legislative or statutory changes that needed to be made with respect I guess to OMB's responsibility or the way they carry things out, but let me just raise the issue.

You said a moment ago that either the secretaries, or the managers, or the bosses have not placed enough importance on management. It is not the thing that gets the attention. But yet it is something that is absolutely required. What I sense though is that you are going—that the commitment to the management side of the Office of Management and Budget is going to go up and down pretty much based on either who is running the Office of Management and Budget, or the President, the administration.

It just raises again from my perspective whether we do need to do something from the standpoint of stating the significance of the management side, what kind of resources should be available, what specifically the management side should do, in a sense kind of a job description and the resources to complete that job description.

Mr. **Diefenderfer**. I agree with what you have said, and in fact that is one of the things the Director and I worry about. One of our proposals to try to stop the possible fluctuations of emphasis is to create a second deputy in OMB. In other words, cut me in half and create a deputy for management. We have legislation proposed in Congress, and we are begging that it be enacted by June or July of this year.

There seems to be no opposition to it. It seems to be held up with other bills that are slower moving. The reason why we are begging for June or July, the budget season is going to start in earnest I think in the next month or two, and when that happens generally is that the Director, the Deputy Director, and others are pulled by the powerful vortex it creates into budget questions, and not as much time is left for management questions.

We think that would be one very positive step forward to create this Deputy for Management.

Second, which is not in our purview but in your purview is that we will urge the committees of oversight responsibility to pay attention to the management needs. You cannot put $10 billion into a program and not allow a significant amount of money, one-half of

1 percent, a percent, on some of that appropriation or authorization to flow to management of the program. It can't be starved.

In the past Congress and OMB together, the executive branch together pooled resources from the management side of all the houses within Government, all the management houses in Government, because we collectively thought this was an easy place to take money and there was no immediate consequence.

I think this would be a very positive activity. My memory tells me that in fact this committee did that in some recent housing legislation where you set aside a half a percent. It is proposed in the 1991 budget that a certain percentage be set aside for management obligations and responsibilities. This would be very, very helpful.

If there were a governmentwide standard for that, that might not be a bad idea.

Senator **Mack**. Let me just touch on you've now gone from the low point of I guess 47 or so people assigned the responsibility on the management side to—additional?

Mr. **Diefenderfer**. We're heading to, we're hiring staff. We've just been to several business schools and we're recruiting. And I think we've had some success there.

Senator **Mack**. We're heading to how many?

Mr. **Diefenderfer**. We're heading up to about 80.

Senator **Mack**. A total of 80. So you'll be adding 33 or so to your——

Mr. **Diefenderfer**. Something like that.

Senator **Mack**. A figure I heard a few minutes ago was 70 reports? Are there roughly 70 reports that come in under FMFIA?

Mr. **Hodsoll**. Reports? Well, there's a report under law from every department and agency. And you've got 14 Cabinet departments and a little over 50 independent agencies.

Senator **Mack**. So it's close to the 70.

Mr. **Hodsoll**. Yes, that's close to 70.

Mr. **Diefenderfer**. We get reports from people I didn't know existed before. Battle Field Monuments Commission and, you know, it goes on and on and on.

Senator **Mack**. Do you feel that with this increased staff that you have—I mean, that's only one, I assume, just one of the many responsibilities of the people on the management side.

I mean, we saw, as we went over this material preparing for these last several days of hearings, you could see one year after the other the same shortcomings in internal controls or management responsibilities being reported. And nobody was doing anything about it.

When I say "nobody," I mean it wasn't just OMB, the Congress. Nobody responded to the thing.

Do you feel that even with the increase that you're going to have a sufficient control of that?

Mr. **Diefenderfer**. My guess is that we will be coming to the Congress for a few more. But, we thought that our request level was prudent at the time we made it, because we couldn't identify the 30 or 40 people we wanted and hire them immediately. There are all different levels and you have to go out and interview, and it's a very sort of rigorous slow process.

I think we will have completed that process sometime this year. And then we'll be able to assess a full complement of what we asked for is capable of. And if we're not capable of standards that we would like to achieve, then we'll be back to ask for more.

Mr. HODSOLL. If I could just add to that, Senator. I think that, even if you had a hundred more people, you still wouldn't be able to cover all of the programs and all of the management problems that exist out there.

So I think that, however many people you have at OMB, ultimately, you have to establish a strategy which includes the political system, as Bill mentioned, Congress, executive branch, GAO, IG's and all of them, to agree on long-term fixes to the many, many problems we know are out there.

There are dozens and dozens of GAO reports, IG reports, that simply lie unattended. And every 3 or 4 years, you get another one in the same area and very little has happened.

My own view is that you have to pick a few of these. If you have a few more people, you can pick a few more. But, probably, the political system can't deal with more than a few at a time in terms of committees in Congress and everybody else.

Senator MACK. Let me make a point there. At least, people would be pointing the finger at us as opposed to pointing the figure at you all.

Mr. HODSOLL. Well, they can point it at us, too. I'm not suggesting that.

But, if we can get a few of these things actually done, and HUD is a good example, there's a lot of pressure now in the area of HUD, and if we can work concertedly and with a rather single mindset on HUD, we may actually be able to get them the financial systems that they need in order to function and the kinds of procedures to avoid these things that have happened in the past.

And I would argue that we should concentrate on a half dozen of these things and really get them done, not just have the same problem again 3 years from now.

Mr. DIEFENDERFER. Frank mentioned the need for a strategy, and we have put several strategies in place. And I will just briefly describe one. The high-risk area, 100 high-risk areas. We have announced what they are to the public, and to you all, what the time tables are for addressing those problems, and what the milestones are—all publicly done.

Now, politically, that is probably not the wisest thing to do because it gives your political opponents a yardstick that was created by yourself to judge you in 2, 3, or 4 years and to criticize you if you've not met up with it.

We thought that through in our minds and said:

It's worth it. That creates the kind of tension within the executive branch—creative tension, we hope—that will induce our political appointees and others to follow through.

We have also not been shy in terms of strategy of telling committee chairmen straight up:

Look, we failed, but so did you.

And it's a shared blame. It's not trying to put all off on you or all off on us. And within the beltway, we point the fingers. But, if you go outside the beltway, they just point to the circle which is the beltway. It's you, it's us, it's the departments. And they just want "us" to clean it up.

Senator **Mack**. Let me just make a quick comment and then turn it over to Senator Graham.

I still sense though that what's missing is that there is no general agreement as to what we should as a Government be doing from the perspective of managing.

I mean, if you tell me that the sooner you get all the people that you want, you're going to have roughly 80 people out there managing, overseeing, inspecting this huge Government of ours.

I mean, that's not much. And I guess, somewhere, we can—and I do want to turn this back over to Senator Graham—but it seems that we need to come to a conclusion in government as to what we want to manage, how we want to manage it and what kind of resources we want to provide to that entity.

Senator **Graham**. I wanted to go back to history again and focusing specifically on the relationship between OMB and the Department of Housing and Urban Development.

One of the other areas that has been surfaced in a previous hearing is the relationship between OMB and HUD relative to specific managerial functions.

In 1989, GAO issued a report in which it stated that OMB had a very short-range vision from a financial standpoint as to policymaking. An example is when in 1983, HUD had proposed to refinance its section 235 mortgages, some of which were carrying interest rates of up to 17 percent.

The HUD Inspector General later projected in 1986 that refinancing those mortgages could have saved the agency as much as $844 million over the term of the mortgages.

The proposal for refinancing was rejected by OMB. The reasons given were, first, that it would have appeared to have increased HUD's budget; and, second, that OMB was concerned that the money saved by the refinancing would be put back into the section 235 program.

I'm concerned about this assessment of a short-term perspective of OMB's financial timeframe.

How would a decision like that, which might be submitted to HUD today, be evaluated? And I wonder if you or some of those who were here in the past could comment on our assessment of how that issue was, in fact, handled during the Pierce years.

Mr. **Diefenderfer**. Yes, sir, I think if I can. And if I fall short in some areas, I will be glad to ask those who have accompanied me.

First of all, the career staff at OMB did recommend against pursuing the IG's proposal. That should be viewed in the context of the fact that they thought the section 235 program itself was not a very good or efficient program.

And then came the next context, which was:

Well, this would be all well and good if, at the same time, we can get Congress to agree to rescind the BA that would come from these newly freed-up refinancing mortgages.

What they were looking at was the potential for a program that they thought was bad to double in size because BA would be freed up for this program to expand its size.

When they made this analysis, they assumed if we could get recision from Congress of the program, then there would be a discounted net present value to enacting this of $129 million, which is positive.

If you looked at that, you'd say that's sensible, I'm going to do it. But, if you assumed that Congress wasn't going to rescind the BA, underlying the program, then it was a loss of $76 million. Not a gain.

So, on that basis, if you look at the possibilities—and you believed that Congress wouldn't rescind underlying BA—you wouldn't make the recommendation.

I might go further to say that, in 1990, we did propose this because we came to an understanding with the subcommittees, the Appropriation subcommittees involved. They did rescind the BA and, because of the way this particular program was structured, the discounted net present value to government over a 20-year period is about $217 million.

So there was underlying quantitative analysis that said: Yes, you could save money if certain political things were done in conjunction with it.

The belief at that point in time was that the political things necessary to make it a net saver were not possible. When they thought it was possible in the most recent 1990 appropriation bills, we pursued it with the Appropriations Committee. And, in fact, did achieve it. And it was a net saver.

I think that is the extent of the analysis. I've looked over the memos from the past and talked to the staff personally as to why they recommended X, Y, or Z. And this is their explanation, one that I find wholly cogent.

Senator **Graham**. You mentioned the fact that there was a basic hostility toward the 235 program.

It's been suggested that maybe there was a basic hostility toward housing programs generally in HUD, and that one of the ways of sinking programs that were at the congressional level sufficiently armored to avoid being sunk was to run them very poorly.

That would create a public dissatisfaction, hostility, that would eventually lead to their dismantlement.

Was that part of the reason why there was this level of management in HUD?

Mr. **Diefenderfer**. Well, if that were true, the corollary should be in Defense that we would have said:

Let's manage Defense very, very well because Defense was the pride and joy of the administration.

I don't think so. You mentioned the word "hostility." And sometimes I think political is probably an inappropriate word. I have found the career staff at OMB to be very apolitical and very, very analytical. And they make their judgments for the most part that I have seen in the year and some months that I have been there now on a purely analytical basis.

There was no, in any of the memoranda or discussions that I have had with them about this decision, hostility to the program. It was that the program just didn't work. It didn't provide the services and the benefits that it was supposed to on paper; it was just a badly formed program.

And it's not a matter of hate or hostility because their whole lives would be consumed, because we've got thousands of programs that we review. And there's some they support, some that they don't. But it's an analytical determination, it's not emotional or an ideological determination.

Senator **Graham**. Speaking generically, you're in an administration which believes that the Federal role in housing is inappropriate, certainly excessive, and you need ways to implement that policy; this program was created by a Congress which is still basically sympathetic to housing. How do you go about implementing the administration policy?

Mr. **Diefenderfer**. One could suggest that the way in which HUD was treated during the Pierce years was almost a classic, a case book example of how to accomplish a policy goal without doing it through the normal democratic process.

One can come to that conclusion. The conclusion I would come to is that they didn't pay any attention to those programs because they didn't care about the programs. They didn't go out of their way to make them run poorly or to make them run better.

If you asked how I would do it, and the way to do it, if you think something's wrong, is you prepare the best analytical case you have and then you prepare the best political case you have, and you go at it from the grassroots level to the top level and attack the programs.

I've done that in work in the Senate. When we did deregulation—trucking, railroads, bus lines, broadcast. And as chief of staff for the Senate Finance Committee when we attacked the Tax Code in 1985 and 1986, that was essentially the process we went about, and that's the way we did it. And that's the way you can be effective.

I don't think you can be effective by benign neglect, so to speak, because—some people, call themselves the "Be" staff. They "Be" there when you come and they "Be" there when you go, so to speak.

And if you just take a benign attitude toward them and don't approach them in an analytical way, they will be there after you're gone.

So I don't think that there was any sort of grand strategy. And if that was a grand strategy, it was a damned poor one in terms of getting rid of something.

Senator **Graham**. The grand strategy of OMB management during the Pierce years was referred to as Reform 1988, which was titled as an effort at enhancing the management of the Federal executive agencies.

Could you explain exactly what Reform 1988 consisted of and your evaluation of its effectiveness?

Mr. **Diefenderfer**. If I could, I would like to pass this to Mr. Hodsoll.

Mr. **Hodsoll**. Thank you.

Basically, Reform 1988 was put together in the early 1980's as a long-term program of management reform. It concentrated primarily, Mr. Chairman, on the issues of financial management and a number of significant improvements were, in fact, made, for example, in cash management, managing the $2 trillion in cash flow that the Government has each year, in the sense of providing for electronic transfers, for providing faster flow so that you reduce the float, and thereby the Government doesn't have to pay the interest on that money in the meantime.

There was also an effort, as a part of Reform 1988, which was less successful. That was to provide for integrated financial management systems by 1992, one in each department and four at Defense.

I have to report that that is so far off schedule as to be somewhat ludicrous. We need to get it back on schedule. That wasn't necessarily the fault of Reform 1988, but it was, to revert to something I said earlier, the fault of follow-through, of systematic follow-through program by program—nitty-gritty by nitty-gritty, inching your way towards it "downtown" and in the relevant committees in Congress.

Also as a part of Reform 1988, efforts were made with regard to productivity improvement. The budget process was used here in setting goals as to how many people you could save by providing for greater productivity. We've turned that into what one might call a total quality management effort which relies less on the tools of productivity than it does on creating team efforts ultimately to make changes in the departments.

That was really the core. I might say that, among other things that happened, however, under Reform 1988, a number of pieces of legislation were, in fact, proposed and enacted. While not specifically a part of it, the Federal Managers Financial Integrity Act came about at about that time. The Debt Collection Act, the Prompt Payment Act, all of these were part.

And here Congress joined with the Reagan administration in actually—more in the cash area, to some extent in credit—coming up with ideas that were followed through.

I think, if I were to state in conclusion, a strength and a problem with Reform 1988, they would be as follows:

First, the strength. The strength was that it was a long-term commitment and bite-sized pieces were taken off and, not in all cases, but in a number of cases, accomplished.

The weakness was that it didn't go to some of the core management problems in terms of bringing together human and technical resources, combining them with systems, to ultimately make the programs themselves, as opposed to administrative aspects of the programs, managed in a better fashion.

Senator **Graham**. Do you have any specific comments as to how you think the Reform 1988 program affected HUD?

Mr. **Hodsoll**. I don't. I'm sorry. I don't know. Some of my colleagues might.

Senator **Graham**. In the law, there's a principle that if you're walking along the beach and you see a person drowning, you generally don't have any affirmative obligation to assist that person.

But, if you're walking along the beach, see someone drowning and you wade into the beach halfway towards the individual, with every appearance that you are about to provide aid, and at that point, you discontinue and walk away, you do have a responsibility, because having taken that action, you may have dissuaded somebody else who might have come in and helped the drowning person.

I have a feeling that we're in that situation. That there have been things said and started that point towards improved management, greater control and a sense of assurance that things are going to be under control. I have the statement that was made by President Nixon in 1970, when the Office of Management and Budget was created.

And he said:

> The new Office of Management and Budget will place much greater emphasis on the evaluation of program performance, on assessing the extent to which programs are actually achieving their intended results and delivering the intended services to the intended recipients. This is needed on a continuing basis, not a one-time effort. Program evaluation will remain a function of individual agencies. However, a single agency cannot fairly be expected to judge overall effectiveness in programs that cross agency line. And the difference between agencies and Presidential perspectives require a capacity in the executive office to evaluate program performance whenever appropriate.

That was a statement of what the Executive was going to do. And then, 10 years later, reinforced with the Reform 1988 statements.

And I think that helped to put a lot of people asleep, feeling as if your agency was actually doing what President Nixon had stated, at your birth, would be your charge.

Do you feel as if there has been some appearance of action that has not fulfilled its rhetoric, and possibly discouraged or dissuaded or anesthesized others?

Mr. DIEFENDERFER. Absolutely, to the point that there have been attempts, which I guess crossed political lines, to give the appearance of action, it seems to be a . . . a shortcoming of political activities.

As to dissuading people to take interest or cause them to slumber, I think those people would have been pretty close to slumber anyhow. I mean, it's been no secret to anybody who has an inquiring mind or interest in this that action hasn't been taken from the very first day.

There are all the reports that we can keep going back from the early 1970's into the 1980's, where IG's and GAO and others are saying, Hey, this isn't happening.

And all somebody had to do was read those, in OMB or executive branch or Congress or newspapers, or whatever. People just ignore it because it wasn't of interest to them.

If you want to say, Look, what can we do in one fell swoop? Where should we target to make the biggest improvement?

About 25 percent of the high-risk areas that have been identified are in financial management. The sad truth is, if you were running the Government as you were a business—I had a small law firm, 25 to 30 people. I did the books, the statements of accounts, et cetera. And you come in and you say, OK, what are our assets? What do we owe? What is owed us?

We don't have a clue in a readily accessible fashion. When we were trying to find money for the drug wars, we said, Well, OK, unobligated balances. What have been appropriated or been authorized in the past that we haven't used? What's laying out there that we can put our hands on?

The answer is we don't know for a year, when we look back, it would be December, the previous year from that December. It's 12-

month lag. And even at that point in time, the information isn't all that accurate.

And this is the principal area where Frank and his people are putting a lot of OMB's effort into, is trying to get these financial management systems up and running and to have them be integrated with Treasury, OMB and all the critical points that digest this kind of information.

But it is not there now. There's no semblance of it.

Senator **Mack**. That's a depressing thought.

Let me just go back to the comment you made about the FTE's. I think, from roughly 16,000 to 12,500 were the numbers that you used.

I think some people have used those numbers to indicate that, yes, I mean, that's evidence that it was clearly the intention of the Reagan administration to come in and do away with HUD.

I guess there are a couple of thoughts. One is did OMB through the budget process, in essence, direct HUD to reduce the number of fulltime—I assume that's full-time equivalents?

Mr. **Diefenderfer**. Yes, sir.

Senator **Mack**. From 16,000 to 12,500 over a period of time either just by finding ways to reduce the staff or developing programs that would reduce the staff?

I guess the second part of that question to me is:

Would you draw the conclusion that as a result, if they, in fact, did that, that the intent was to do away with HUD?

Mr. **Diefenderfer**. OK. The stated policy of the Reagan administration was to reduce full-time equivalents governmentwide by 75,000 by 1984.

Now it wasn't the stated—and that's not just HUD. Other areas were included also. Commerce Department. You name it.

The activity that was supposed to be pursued, and I believe was pursued, at least I've seen no examples where it wasn't, were things like, in the HUD area, the CDBG administration was transferred from HUD to the States to administer. They thought that was a better programmatic way to deal with CDBG. That would result in a decrease in the number of FTE's because those people were no longer needed at the Federal level.

There are any number of other activities. And that was the type of activities that were undertaken to achieve the goal of this overall of 75,000 FTE reduction across Government. As I said, HUD went from 16,000 roughly to 12,600.

Senator **Mack**. But the other part of the question was——

Mr. **Diefenderfer**. I don't think it was any intent to go just at HUD. And that's evidenced by the fact that there were significant reductions in other departments as well. It was trying to eliminate jobs that could better be performed in the private sector, could better be performed at the State level. And that was what was behind the intent. It wasn't singling out HUD individually.

I've talked with the staff about this and that is their opinion also.

Mr. **Hodsoll**. There were actually deeper cuts in some other departments.

Senator **Mack**. So, using the reduction in staff as evidence that it was the intent to do away with the Department really, if you compare it to other departments, you are going to find that there were reductions made even of greater——

Mr. HODSOLL. Even deeper.

Senator MACK. Let me get back to the FMFIA reports and kind of that whole process. Again, 70 reports coming in. Give me a feel for how you are going to now follow up on those. I think you mentioned that there were people assigned to different agencies. Give me a feel about how that's going to work because I guess, again, bottom line really is:

Does someone believe that the report is going to be read? And once read determine that there are things that need to be done, go back and sit down with those who said there were problems and say: We agree that there are problems. We want to hear what your recommendations are. And there would be a procedure in place that would follow up to see whether those recommendations or those proposed changes have, in fact, taken place.

Tell me how that will work.

Mr. HODSOLL. If I may, Senator, I need to go back to I think it was July of last year and give you a sense of where we started and where we are today, if that's OK.

Shortly after the HUD scandal broke, in the sense of becoming highly public, Dick Darman brought in all of the deputy secretaries and the deputies of EPA and NASA to the White House to talk about the FMFIA and audit followup. Some of them had never heard of it before. We brought in our senior inspector general, Vice Chairman of the President's Committee on Integrity and Efficiency and the Vice Chairman of the President's Committee on Management Improvement, and asked the deputies to produce a personal assessment of the 1988 reports.

They did that. It was on the basis of that and going through them that the OMB staff essentially said we've got a lot of cats and dogs, apples and oranges here, big ones and little ones. And out of that, we came out with our high-risk list of 106.

Those reports were, first of all, discussed with the inspectors general of each of the departments and agencies and they were coordinated with the agencies before we went back to them. We then gave those reports to the Senate Governmental Affairs Committee and the House Government Operations Committee, and they released them to the public.

So now we have these things on the public record as well. And the President, I might say, personally, in two Cabinet meetings, brought these matters up with the Secretaries of the Cabinet.

We now have the 1989 reports in. We are in the process, we have not completed that process, of doing the same thing with the 1989 reports. We also now have a computer system essentially to track the milestones towards achievement of the corrections.

In the course of preparing for the 1991 budget, in a number of areas, we actually added resources where we thought there were significant problems. And HUD was one of those areas.

So that's what we're doing now. Tracking is not enough. But we are doing that.

Senator MACK. Yes, I was just going to say to you. And I assume that you're the one who is presently responsible for this information to flow up to you?

Mr. **Hodsoll**. I'm in charge of at least this process, yes, sir.

Senator **Mack**. Will anyone on the staff go out into the agency to inspect firsthand as to whether these, quote, "milestones" or these proposals are, in fact, in place?

Mr. **Hodsoll**. We will not be able to do that in every agency, but, in fact, sitting behind me there is our management analyst who spends most of his time at HUD, working with them along the lines of what Under Secretary DelliBovi told you just a few days ago, to come up with specific actions to address each of those problems.

In the HUD case, if I may say so, a principal problem is not having a decent financial management system that can, on the one hand, provide accurate information and on the other hand show you where things are going wrong.

Senator **Mack**. And do you have within your shop the internal controls, if you will, to make sure that this is brought to your attention and that in a systematic way that you are following up? [Laughter.]

Mr. **Hodsoll**. That might bear some looking at, but I think at least because we're so small, I'm fairly confident that we have that. I have a PC on my desk, and there's regularly new material on milestones on my PC.

Now, whether we're getting every one of them, Senator, I can't certify to.

Senator **Mack**. Let me ask you this. What role do you think the Congress has in all of this? I mean, during this period, I guess 1983 was the first FMFIA report. And so, you know, in the Senate anyway, at least Republicans had control for a few of those years, and since then, the Democrats. So it's not raised in the sense of a partisan issue here. It's just a question of what truly is the responsibility of the Congress?

In some respects, I kind of look at us as—and, again, maybe it's because I come out of the business world—as kind of being a large board of directors who has the responsibility of looking at what management is doing, which is the administration.

And the reports that are like FMFIA, we ought to take those seriously from the standpoint of kind of like an internal audit committee. That's what I was referring to a little earlier, or that Senator Graham was referring to a little earlier.

We're almost like an internal audit committee that reviews these documents and raises these issues. But I'd be interested in what you think our role should be.

Mr. **Diefenderfer**. Well, I have testified and I'd like Frank to add to it if he has different views or additional views, is that every committee chairman should assign to each subcommittee chairman as part of his right or her right to be subcommittee chairman oversight in the particular areas that they have jurisdiction.

The type of hearings that you are conducting now, these are not fun, I know, for you or for the staff. They are sometimes intellectually stimulating. Other times, I'm sure that they are not.

But, it evidences your concern about the programs that you're responsible for. And I'll tell you, when the Congress is interested, it sends the fear of God into the executive branch; from the career levels up to the political levels, people worry. People want to look good. They want to have the right answers.

That kind of response from the Congress, governmentwide, I think would make a very large difference.

I think also it would serve to give governmentwide, including Congress, more credibility with the public, because what you would do would improve the management of government if this was done Congresswide. Government would look better. People would have a better attitude toward government.

Their attitude now, in my judgment, and I've said this once before, before the committee, is that:

When President Bush made his nc new taxes statement, there are different segments of people who respond to that. One is people who figure that taxes are bad for the economy and they don't want to see taxes for that reason.

A whole other set say, Look, I don't want to send good money after bad. They'd be willing to pay more taxes for X, Y, Z if they thought the monies would be efficiently and prudently used. They don't think that now.

So, for those who would like to increase taxes, this should be one of their No. 1 objectives, is to make government credible. And I think Congress could help by being an oversight body.

I can remember when Mr. O'Neill was the Speaker. He designated one session of Congress as the Oversight Congress. I forget which one it was. And then the House proceeded to do very, very little oversight. You had some people who did that—Mr. Dingell and others. Mr. Brooks, who have reputations for strong oversight. But, generally, it didn't make much difference.

If we could get an oversight attitude in Congress governmentwide at the subcommittee level, I think it would make an immense difference as to how the administration, executive branch conducted themselves.

Senator **Graham**. Connie just asked what was going to be my concluding question. And that is:

What, from your perspectives, should we be doing to carry out our function better?

Do you feel that from the reports which are currently being provided, including FMFIA and periodic inspector general reports, that there is enough information available to the Congress to carry out its board of directors function?

Mr. **Diefenderfer**. I think that there's presently enough information available for Congress to use up a significant amount of its time before it needs more.

I would not say that these reports are perfect and that they couldn't be more elucidating of the problems.

I've encouraged the IG's, for example, who put out semiannual reports—which you have to be a saint to try to keep your discipline to read some of them—to put on the first sheet the seven biggest problems in their department? Simply stated. One line. And the costs that not attending to these problems cause, to help catch people's attention. Busy people, who don't have time, like yourselves, to read several hundred pages.

Some of them have started to do it. So there are changes in the format and some of the substances provided that I think would make the job easier on Congress. And I would encourage executive branch, IG's and others to change that format and provide the data if it would help encouraging oversight of the sort that your committee, subcommittee is doing, sir.

Senator **Graham**. To extend that, I think, in some ways, we may have too much information. And it is so ominous, foreboding that we run from it.

While I was Governor, we tried to determine what we thought was the essential data from each of our executive agencies. Maybe, with the Department of Transportation, it was how many miles of road have you maintained in the last quarter and what it cost you per square foot to do that maintenance.

You've got at OMB essentially the same problem we have, a massive Federal enterprise to try to oversee with a limited number of people.

I'd be interested in maybe OMB and the Congress working together to try to discern what that essential, most illuminating set of data is. It would probably be somewhat more extensive for you than it would be for us. But ours could be a derivative of yours, so that we were consistently focusing on the health of these agencies and not reacting to crisis.

Mr. **Diefenderfer**. We would welcome the opportunity of working. And as a gesture of our willingness, I would ask that our staff, to present you, in 30 days, in the areas of your jurisdiction in this committee what we think good indicia are to measure the value of programs.

For example, loan to value ratio in FHA, and these sorts of things that might be good milestones for you to judge.

[This information is contained in the letter in appendix.]

Senator **Graham**. Thank you for that. I accept. And if we could focus on HUD, what do you think are the essential data-bases within the programs of HUD that you're going to be looking to and that we might sample for our oversight purposes.

Are there any other areas of recommendation that you would have for Congress to better carry out its oversight of HUD and of the other Federal executive agencies generically.

Mr. **Diefenderfer**. Not that we've—we've talked about all of the suggestions that I'm aware of that I think have some credence.

Mr. **Hodsoll**. The only thing I would add, if I may be presumptuous, is that Congress, as well as the executive branch, continue oversight even in good times. The effort to look at the management of Federal programs should continue, as it would in a corporation, on a quarterly or monthly basis, whatever it is, no matter what—good times and bad times. Because only in that way will one have a sense of, if you will, what the trend is.

Senator **Graham**. And I think, in addition to having a sense of continuity, there needs to be a sense of focus on ultimate objectives. And what we're interested in are those indicators that reflect consumer orientation to the agency.

Are we accomplishing what caused us to be established in the first place?

I have one question that was requested by the Senate Appropriations Committee. Apparently, when OMB received extra funding for management, there was a promise that there would be periodic reports to the Appropriations Committee, quarterly reports on how the management process was evolving.

That commitment was made in August. They tell me, sad to say, that as of mid-April, no reports have been submitted to the Appropriations Committee.

Mr. **Diefenderfer**. We should remedy that. [Laughter.]

Senator **Graham**. I'm suggesting that we have an area here that would contribute to enhanced congressional/OMB relations.

Mr. **Diefenderfer**. You've just done it. If we made the commitment and haven't lived up to it, we'll rectify that.

Senator **Graham**. Good. Thank you very much, Mr. Diefenderfer, Mr. Hodsoll. I appreciate your help, and also to your staff, who have been helpful to us.

Thank you.

[Witnesses excused.]

Senator **Graham**. Our final panel today consists of three people who have considerable knowledge about OMB and the Federal budget process. Professor Hugh Heclo, now at George Mason University, and formerly professor of government at Harvard, is a well-known academic who has written extensively on the Federal budget process, including the role of OMB in dealing with both agency budgets and management.

He also was a consultant to the President's Reorganization Project of OMB during the Nixon administration.

Mr. Harold Seidman is a 30 year veteran of the Bureau of the Budget, which was OMB's predecessor, where he headed OMB's management efforts during the Johnson Presidency. He is currently a guest scholar at the Center for the Study of American Government at Johns Hopkins University.

Mr. Alan Dean is a fellow of the National Academy of Public Administration. He served as a senior management analyst at the Bureau of the Budget from 1947 to 1959, and later became a deputy associate director at OMB during the time of President Nixon's reorganization of that agency.

Mr. Dean also brings to this panel some firsthand understanding about the management of Federal agencies, as he was the first Assistant Secretary for Administration for the Department of Transportation.

I would also like to mention that our subcommittee has received a written statement from Mr. Dwight Ink, who appeared at our Friday hearing to discuss staffing. Mr. Ink coordinated management efforts for both the Bureau of the Budget and the Office of Management and Budget.

He was unable to join us today, but has submitted some very useful information regarding OMB, and we will enter his statement into the record. [See p. 218].

Gentlemen, I appreciate your being here today and, as we have with the two previous panels, would you please rise and raise your right hand?

[Witnesses sworn.]

Senator **Graham**. Thank you very much.

I will call on you as you are listed in the agenda. If you have an opening statement, then Senator Mack and I will have some questions.

Professor Heclo.

STATEMENT OF PROF. HUGH HECLO, CLARENCE J. ROBINSON PROFESSOR, GEORGE MASON UNIVERSITY, FAIRFAX, VA

Prof. **Heclo**. Thank you. I appreciate the opportunity to appear before this subcommittee. I do not have a written statement, but I would like permission to send one later because I have certain ideas which I think might be helpful.

Also, I'm committed to teaching a class tonight, so I'm going to be very, very brief.

Senator **Graham**. All right. Is there a time that you need to leave?

Prof. **Heclo**. I should leave here by a little after 5 to get back to the University.

Senator **Graham**. We might take that into account and direct what questions we have to you first. If either of the other gentlemen have a time constraint, if you would let us know, it will be our intention to try to conclude by no later than 5:30 in any event.

Prof. **Heclo**. Thank you.

I own the dubious distinction of being one of the few people that probably ever sat down and read through the whole deliberative documents surrounding the Ash Council, which, as you pointed out, created the Office of Management and Budget in 1970.

And I have, of course, followed OMB since then and gone back before 1970 in my research. In fact, when I first came to Washington, one of the first people I interviewed was a man named Fred Lawton, who was not only a Director of the old Bureau of the Budget in the late 1940's, but before that one of the key financial and management career officials in the BOB.

Going through this long litany of promises about management improvement, all I can say to you is that it is very, very depressing. The glittering hope that's held forth:

At last we've got the right answer to how to bring better management to the Federal Government. And if we just do this with OMB or just make this change with management by objectives, or President management initiatives, and year after year.

And what happens?

Not just scandal but really horrendous developments. And I found it very difficult, listening to one of the earlier witnesses today, to understand how anybody could say that the system isn't broken. The system has been broken at HUD for years. The system was broken with the Savings and Loan fiasco, with the Pentagon procurement scandals and so on. One of the books I'm reading right now is about the Wedtech scandal, which is appropriately entitled "Feeding Frenzy."

And, year after year, you see these disasters develop. All of this, or at least much of it, occurring at the same time as OMB's power of oversight has increased vastly over what it used to be. All of this at a time when the M in OMB was supposed to finally mean concentration on management improvement.

Let me say, in my comparative studies of Government management, I don't know of any other string of disasters that compares in any developed country with what this country has gone through in terms of financial and management scandals at the top levels of the executive branch.

I mean, we're not talking about terribly sophisticated management failures. We're talking about basic thievery going on.

Senator MACK. Basic what?

Prof. HECLO. Thievery.

Now, was it a problem that we didn't get early warning signals? I tend to think that wasn't the main problem. Since at least 1978, Congress has been warned repeatedly about problems, in particular in HUD operations. The 21 semiannual IG reports, from 1981-83, the inspector general's investigations at HUD led to the resignation of two Assistant Secretaries and two regional directors.

Throughout this period, the inspector general never heard from Congress. In 1983, the IG report warned of huge overcharging. From 1981 to 1985, according to the then-inspector general's testimony, he did not receive one phone call from an oversight committee of Congress. The information was starting to pour out.

The 1987 promotion of Mrs. Dean provoked some congressional concern but, overall, very strong congressional support.

And finally, in the spring of 1989, Congressman Lantos' original hearings began, as I understand it, after he read a newspaper account of one inspector general's report detailing HUD favoritism.

What these kinds of stories tell me is that we don't have a problem of early warning signals. The problem is on the receiving end. The receivers aren't tuned in right. They aren't hearing these things and taking appropriate action.

Let me briefly turn to OMB. I'm very much impressed with the efforts at reform that have been indicated to you today and prior to this. On the whole though, in the long run, I do not believe you can expect much more help in this area from OMB. The budget is just too all-consuming. And I don't think adding more people is, in the long run, going to provide any basic assurance that we can put these kinds of problems behind us.

I agree very much with Mr. Diefenderfer. What we need, as he put it to you in an earlier hearing, is detached professional criticism in continuous review of management performance. I don't think the long-term prospects are for that to happen in OMB.

I say that after watching what's happened, not in any one administration, but time after time after time. There was a very good account of the general instability and lack of management follow-through in the history of OMB in the Comptroller General's report in May 1989. And in there, he sets out a bit of the history of the management side of OMB as it moved from the Fred Malik era with Management by Objectives on into another era with another cast of political characters, on into the next era of Government reorganization under Harrison Wellford and Mr. Carter, and then on to Joe Wright's period in the 1980's—always these management initiatives are overwhelmed by the consuming importance of the budget process, by the lack of attention of political short-termers throughout the top three layers of OMB.

Just take an example. I was astonished to read in the testimony that Ms. Crawford gave to you, when you asked her, "Did you look at the Inspector General's reports?"

The answer was: "No, we assumed the people on the management side were going to do that. We didn't have an oversight role for the agency."

"Do you know what the management side was doing?"

"No."

"Who were the people on the management side?"

"I can't quite recall them all. I think there were two or three."

Two or three of her management counterparts in a 3½-year period of her tenure?

Management as such has never fit very well with the OMB. Nor before that, in the old Bureau of the Budget. You talk to some of the old-timers, like a Sam Hughes or a Don Stone, who go back to the 1940's under Franklin Roosevelt. It was then called the Division of Administrative Management. Management has always been a problem in OMB. It always will be. Mr. Darman is trying to make a serious effort. I am sure Mr. Diefenderfer is. What happens when Mr. Darman goes on to maybe be Secretary of the Treasury or president of Solomon-Lehmann Bros.? Another management initiative, another cast of characters, and so on and so on.

I think Mr. Diefenderfer is right. This is a cultural problem. People have to be inculcated with the idea that management is important in reviewing executive agency actions. But, building a culture is something that's a long-term process. It has to be nurtured from one year to the next, from one generation of bureaucrats to the next.

In the old days, in the old Bureau of the Budget days, that did happen to some extent. Now, with OMB and the political layering and the constant turnover at the political appointment levels, you don't have a chance to build this kind of oversight culture that would be truly needed.

And I don't see any prospect for it developing.

Does that mean you should extract out the M from OMB and set up a separate organization in the Executive Office of the President?

It sounds good and I think my colleagues are going to disagree with me on this, but I don't think that's really the way to go either.

That is, in a sense, doing what we've always done—trying to build around the current weakness without correcting it. If OMB can't do the job, then we say, "Well, that's OK, let's just set up an M outside of OMB."

The second problem is that an outside management unit in the EOP is likely to be overwhelmed in the whole process of consulting with the President by the people who are closest to him.

Management, as Mr. Darman has said, is not a sexy thing. It's always hard to get the President's ear. It's always hard to get agencies to respond to efforts of management improvement.

I think the management effort will be even weaker if it's set outside the budget agency. Right now at least you do have the possibility of biting agencies with the President's teeth through the budget process. Put it outside and I think it's likely to become some formalistic management process that everybody responds to with lip service, but nothing much really happens.

And we're not talking often about terribly difficult things happening. It's a question of finding out what's actually going on in those agencies. Good management systems help but, often, it's just a people-to-people thing. That's one thing I've learned in talking with experienced folks at BOB and OMB.

In the old days, BOB officials used to know what was going on in the agencies because they hung out with them a lot. I mean, they went to the agency cafeterias and found out what midlevel bureaucrats thought was going on where they were. And in a way, it's the same way your congressional staff, oversight staff, find out the truth. In the old days, they didn't have a Duddington's Pub, I suppose, but there's lots of word of mouth that you can use to find out things without fancy management systems.

The point is you have to want to do it. So, where do I come down? How do you improve the receiving end of things?

I think what's needed is more or less what's happened on the budget side. When Congress found out it could not continue to reliably use the Bureau of the Budget and OMB for the budget data it needed, it set up a Congressional Budget Office to help develop the kind of information that let it do effective oversight and decisionmaking on the budget process.

I think we need to think about some form of improved congressional staffing that could help Congress develop and evaluate all this management data that's coming through. Those reports are worth going over, but Congressmen, and in fact, their hard-pressed staffs as they currently are constituted, I don't think can do it. We have these streams of information coming at us—inspector general's reports, the financial integrity reports. We have the annual report, hopefully, of OMB on management improvement.

So, in my view, we need some improved staff capacity to help Congress absorb, digest and highlight the important elements of this information so that you can do what Mr. Diefenderfer wanted you to do. And that is, on a regular basis, just like brushing your teeth, go over the agency's management and find out what, if anything, is going wrong.

Now, I have several ideas how that kind of staffing system might help and how it might be organized maybe within GAO to do a better job of management information reporting. But at the end of the day, that's where I come out.

OMB, they're going to make an effort, but it's really on the congressional side that we have to improve the reception of the signals that are out there, hidden in all that noise.

[The complete prepared statement of H. Hugo Heclo follows:]

Statement of

H. Hugh Heclo

for the

HUD Investigations Subcommittee

Committee on Banking, Housing and Urban Affairs

United States Senate

April 23, 1990

Mr. Chairman:

I appreciate this opportunity to appear before the subcommittee as it struggles to understand the mismanagement of the past and searches for ways to prevent these billion dollar scandals in the future.

During the past twenty years I have spent a good part of my academic career studying political management of the executive branch in general and the Office of Management and Budget in particular. I have done so first as a senior fellow at the Brookings Institution, then as a professor of government at Harvard and currently as a university professor at George Mason University.

Programmed for Scandal

I think it is important to begin by recognizing that the HUD case is not an isolated event -- an unhappy but accidental coincidence where poor departmental management, private greed, and a lack of effective outside scrutiny from Congress, OMB and the press just happened to come together. The late unpleasantness at HUD is part of a larger story that includes the even larger losses incurred through the Savings and Loan fiasco, the Pentagon procurement scandals, and many other such events. A recent book on one of those events, the WedTech affair, is entitled Feeding Frenzy, and it is an appropriate epithet for what goes on year after year throughout too much of American government. Add up the price tag for only these most egregious and well-publicized chronicles of mismanagement and you arrive at something involving, not simply tens of billions of dollars but hundreds of billions of dollars -- a figure many times over what we feel able to spend on the poor or the environment, on federal aid to education or support for the young democracies struggling to be born around the world. It seems as if the federal government cannot afford to play a leadership role (either in American society at home or in the changing regions abroad), but it can afford to be corrupt.

No sensible person can look at what has happened and fail to conclude that something in the system as a whole is broken, if not to say sick. To find comparable levels of endemic mismanagement and chicanery, one must look beyond other developed nations like Japan, Germany, France, or Britain to third world countries or perhaps some of the recently departed communist regimes of eastern Europe.

We should note too that, while all this has been going on, there has been in the last 20 years a vast increase in OMB's centralized power over the rest of the executive branch. There have been glowing accounts of the management improvements to be expected from a succession of new presidential management initiatives. There have been sophisticated new computer-based management reporting systems introduced and a succession of management experts brought in to run the bureaucracy on a more businesslike basis. None of the fancy management techniques have prevented what the ordinary citizen would rightly see as common thievery on a massive scale. The federal government seems programmed for scandal.

A Problem of Reception, not Signals

The HUD case is a good illustration of the fact that the basic problem lies not so much in a failure of early warning signals, but rather in a failure of the receivers to be tuned in properly so as to take timely corrective action.

Since 1978 both the Congress and the President's Office for Management and Budget (OMB) have been warned repeatedly about mismanagement at HUD in the twice-yearly Inspector General reports for that department. Between 1981 and 1983 IG investigations led to the resignation of two assistant secretaries and two regional directors, as well as other financial misdeeds ranging from low-level officials to the undersecretary of that department. The office of Government Ethics began issuing its warnings as early as 1982. In 1983 the Inspector General's report pointedly warned about massive overcharging in HUD's Mod Rehab program. During this 1981-85 period, the then-Inspector General reports that no Member of Congress, including those on oversight committees, contacted his office. In 1987 the promotion of Deborah Dean, a person who turned out to be a central figure in many of the scandals, occasioned vocal Congressional support, in large part because of her willingness to help congressmen with their special constituency projects. Finally, after the mismanagement of billions of dollars, Congressman Lantos initiated hearings last spring after happening to read a newspaper account of an IG report detailing HUD favoritism.

These events repeated a general pattern familiar in other scandals. Indications of the emerging Savings and Loan disaster are to be found in 31 GAO reports, but regular Congressional study of the situation was repeatedly hindered by lobbyists and congressional allies of the industry.

To point out these facts is not to engage in Congress-bashing. There is a wealth of political science studies to explain why any ordinary person of good intentions would probably behave just as today's legislators do. Heavily-overworked elected politicians are not likely to pay more than episodic attention to the signals of executive mismanagement. Their political interests favor mainly those investigations that will make a noticeable media splash. Their need to advocate constituents' interests often leads to interventions in agency decision-making that can encourage mismanagement. On top of all this is the inherent tiresomeness of the oversight work involved; this too creates a predisposition toward missing the early warning signals. Almost 70 years ago Walter Lippman, in speaking about the need for serious scrutiny of government management, pointed out that such efforts

> ...reverse the process by which interesting public opinions are built up. Instead of presenting a casual fact, a large screen of stereotypes, and a dramatic identification, they break down the drama, break through the stereotypes, and offer men a picture of facts, which is unfamiliar and to them impersonal. When this is not painful, it is dull, and those to whom it is painful, the trading politician and the partisan who has much to conceal, often exploit the dullness that the public feels, in order to remove the pain that they feel. (Public Opinion, 1922, p. 369.)

If Congressmen and public opinion are otherwise preoccupied, should we therefore expect an improved, more attentive OMB to take the lead in responding to the early warning signals of government mismanagement?

OMB: More Problem than Solution

In earlier testimony to the full committee, the current Deputy Director of OMB, Mr. Diefenderfer, has spoken of the need for "a detached, professional critic in continuous review of management performance." I agree completely that this is what is needed.

For at least 50 years the prevailing impulse in Washington and within the public administration fraternity has been to look to the institutionalized Presidency for performance of that professional, detached, critical function. Beginning with the 1939 transfer of the Bureau of the Budget from the Treasury Department to the newly created Executive Office of the President -- and again with the 1970 transformation of BOB into the Office of Management and Budget -- there has been a widespread presumption that the President's budget agency should be the focal point for overseeing and improving government management. As a professional staff agency, BOB/OMB gives concrete expression to the Chief Executive's responsibility for government-wide issues of management and budgeting.

This is a splendid theory. Its main problem is that it has never worked out in practice. OMB has become more a part of the government management problem than a resource for its solution. I hope that statement will not be misunderstood. Over the years there have been many extremely able people working at BOB/OMB, and they have from time to time scored important successes in improving government administration. My point is more general. Taken as a whole, the record does not show that OMB can be counted on to play the ongoing critical role that is needed for management improvement. On the contrary, the management function within OMB has never been institutionalized to provide a sustained capacity for overseeing administration in the rest of the executive branch. Organizational turmoil has prevailed on the management side of OMB. Management improvement initiatives have been launched with great fanfare, only to turn into paper exercises that are soon abandoned. Budget staff and management staff at OMB have been separated, merged, reseparated and remerged. The following chart summarizes this sorry history and should give anyone pause about what is to be expected from any new round of management reforms at OMB.

Great Moments in Management at BOB/OMB

1921:	-- Budget and Accounting Act creates a Bureau of the Budget; Sec. 209 authorizes, at direction of the President, studies of executive agencies' organization and administrative methods.
1924-33	--BOB functions as "the President's primary staff agent for ensuring economy and efficiency in matters of routine business." (Dawes)
1937	-- President's Committee on Administrative Management (Brownlow) criticizes "economy and efficiency" approach of BOB; proposes a revived BOB in new Executive Office of the President to exercise direct control of "the great managerial functions of the government" (personnel management, fiscal and organizational management, planning management).
1939	-- BOB transferred from Treasury to EOP
	-- BOB's new Administrative Management Division charged to research and advise executive agencies on ways to improve administrative organization and practice.
1947-49	-- Hoover Commission criticizes Division of Administrative Management for not relating effectively to budget staff and failing to develop a comprehensive approach to management improvement.
	-- Administrative Management Division downgraded and cut within BOB.
1949-50	-- Agency heads directed to report periodically to BOB on establishment of management improvement programs and the results achieved. (Executive Order 10072)
	-- BOB authorized to evaluate adequacy of agency management improvement efforts ("Circular A-8"); President's Advisory Committee created to assist in developing a government-wide program for management improvement.
1952	-- BOB reorganized to eliminate Administrative Management Division; most management staff transferred to units working side by side with budget staff.
	-- Later assessments judge 1950 Circular A-8 a paper exercise essentially worthless in stimulating aggressive efforts to improve management. (Bernstein)

1955-58 -- BOB criticized for failure to provide leadership in management improvement because of preoccupation with budget. Proposals made to enlarge management functions in a reorganized BOB (2nd Hoover Commission; President's Advisory Committee on Government Organization).

1959 -- BOB appoints new Interagency Council to advise on improvement of Federal management.

1961-66 -- New Frontier/Great Society programs designed with minimal input from BOB management side regarding administrative requirements of new social programs.

1965 -- New Planning-Programming-Budgeting System (PPBS) introduced, promising to create a more productive allocation of resources and generate analyses necessary to eliminate inefficiencies in government programs.

1967 -- Management functions criticized as "a depressed area" within BOB not equal to the effective and efficient discharge of the BOB's management responsibilities (President's Task Force on Government Organization and BOB Self-Study Report)

-- New Office of Executive Management created within BOB under noncareer Assistant Director.

1969 -- New Advisory Council on Executive Reorganization (Ash Council) criticizes lack of management emphasis in BOB and overemphasis on budget.

1970 -- BOB transformed into OMB to ensure that "preparation of the budget as such will not be the dominant, overriding concern," with ultimate aim of "improving the management of the entire Executive Branch."

-- Enlarged management staff separately organized from budget staff headed by noncareer associate director.

-- Office of Executive Management abolished after 2 years.

-- New system of annual management improvement reports required from agencies. (Circular A-44)

1971 -- Government-wide PPBS system judged a failure and abolished after 6 years.

1973 -- Separate management staff system judged a failure and management staff merged with budget staff.

-- Management by Objectives (MBO) system initiated.

1974 -- MBO abandoned as a central management initiative.

-- Presidential Management Initiative (PMI) system launched to "reinvigorate OMB's management improvement role and provide for more effective, efficient, responsive, and accountable government."

1976 -- New system instituted requiring agency submission of management improvement plans along with regular budget submissions. (Circular A-113)

-- Routine administrative functions transferred to GSA in 1973 transferred back to OMB.

1977 -- Agency submission of management improvement plans under Circular A-113 abandoned.

-- PMI system judged a failure and abandoned.

-- OMB reorganized to separate management from budget staff under new office of Executive Associate Director.

-- President's Reorganization Project (PRP) launched to thoroughly reorganize and streamline executive branch from 1900 to 200 agencies.

-- Circulars A-44 and A-113 criticized as having no effect and management side of OMB said to have no effective charter to conduct management improvement activities. (GAO)

-- New Circular A-117 issued to promote management improvement directing agencies to assess effectiveness of their programs on a continuing basis and bring closer cooperation between management and budget process within OMB in implementation of new Zero Based Budget system. (ZBB)

1979-80 -- Reorganization effort abandoned and PRP staff disbanded. Number of agencies is larger than at beginning or Carter reorganization initiative.

-- ZBB abandoned after two years.

1979 -- New President's Management Improvement Council created to "identify critical management problems ... and to advise the President on these issues and solutions. (Executive Order 12157)

1981 -- OMB position of Executive Associate Director for Management eliminated after four years. Resources shifted from management staff to budget side of OMB.

1982 -- President's Management Improvement Council abolished.

-- Cabinet Council of Management and Administration established.

-- Reform '88 launched as "one of the most comprehensive and ambitious efforts to improve management and reduce costs ever undertaken by any Administration. (White House Fact Sheet)

1983 -- Circular A-117 criticized as "useless redtape" and lacking constructive relations between management and budget staffs; annual agency management reporting requirements abolished. (GAO)

1981 -- President's Council on Integrity and Efficiency (PCIE) established to root out waste, fraud and abuse (composed mainly of Statutory Inspectors General);

-- New Circular A-123 prescribes policies and standards for agencies to follow in establishing effective systems of internal control to prevent fraud, waste and mismanagement.

1982 -- New OMB Deputy Director initiates reorganization of management staff: Personnel Policy Division abolished and functions transferred to budget staff.

-- New Financial Management Division created with transfers from OMB's Budget Review Division.

-- Management Reform Task Force created to direct Reform '88.

1983 -- Management Reform Task Force disbanded and new Management Reform Division created on management side of OMB consolidating older Management Improvement and Evaluation Division and Intergovernmental Affairs Division.

1983-84 -- President's Private Sector Survey on Cost Control (Grace Commission) created and reports $424 billion in possible management savings over a 3-year period

1984 -- Management Reform Division subdivided into Planning and Communications Management Division (PCM) and Management Improvement Division

-- Management Secretariat created to coordinate all projects of President's Council on Integrity and Efficiency, Council on Management Improvement, OMB support for Cabinet Council of Management and Administration, and OMB support for Grace Commission.

1985 -- Management Secretariat abolished after one year.

-- Grace Commission analysis criticized as naive and inaccurate.

1987 **-- Management Improvement and PCM divisions of 1984 recombined into Government Operations Division.**

1989 **GAO evaluation of OMB's management role concludes, "OMB has not been able to establish an enduring process to integrate management and budget operations. ...Continual modifications have produced confusing expectations of the management roles of the budget divisions and have undermined communication between management and budget staffs... OMB should have had the foresight to understand the long term implications of inadequately addressing major problems. Unfortunately, OMB's history has worked against it taking that perspective. ...Focus on the short term consequences of actions has too often resulted in serious long term problems. OMB needs to change." (GAO 1989)**

This record of false starts, unstable leadership and organization turmoil would be troubling in any organization. In an agency responsible for overseeing the management efforts of others it is disastrous. Thus during the eight years of the Reagan administration, OMB's management efforts were headed by four different Associate Directors and the management divisions were subject to at least six significant reorganizations. The idea of integrating management improvement efforts with OMB budget decisions has been less a management review process and more a passing parade of changing requirements that rarely survived more than 12 months at a time. For example, Management Reviews were begun in 1983 to monitor agencies' progress on Reform '88 projects during the fall budget hearings. In 1984 this was changed to require submissions of more general Management Improvement Plans as a kind of contract between OMB and the initiating agency. In 1985 agencies were required to report every two months on the progress of their initiatives. A computerized system to track progress was created and then abandoned by 1986. In 1986 new procedures required Management

Improvement Plans to be included as part of agency budget submissions. But changing policy leadership at OMB meant this requirement was never enforced and for the last two years of the Reagan administration OMB did not conduct general reviews of agency Management Improvement Plans.

Comes now the latest set of OMB leaders to report plans for newly integrating the management and budget functions, for adding staff to engage in more vigorous reviews of agency management, for creating a new "culture" at OMB. I am not quite prepared to advocate carving words from The Divine Comedy over the OMB management door: "All hope abandon, ye who enter here." But the record of the last fifty years does justify modest expectations. Management oversight has never found a sustainable position in BOB/OMB, as the cycle of merging and separating budget and management staffs has rolled on across the decades. Management improvement efforts have been, and in all likelihood will continue to be, whipsawed between the consuming reality of the budget and the changing agendas of political short-termers within OMB.

Should we therefore give up on OMB and create a separate management agency in the Executive Office of the President? I can understand why a number of people familiar with the history of BOB/OMB have been driven to this conclusion. However, two important reasons militate against this idea.

First, experience shows that management improvement efforts are likely to founder if they are not connected in some way with the action-forcing mechanisms of the budget process. For one things, issues of administrative management and allocation of budget resources are often intimately intertwined. Moreover, it is a fact of bureaucratic Realpolitik that agencies are likely to pay much greater attention if suggestions for management improvement are backed up by the threatening collaboration of budget officials.

The second problem is that a separate agency is likely to make management concerns even more remote from the President than they are today. The political importance of the budget means that the modern budget director is likely to be a major figure with regular access to the president. This offers at least a fighting chance for some management issues occasionally to gain presidential attention and support. By contrast, the head of a separate management agency (like today's directors of the General Services Administration or Office of Personnel Management) will have little politically important business to conduct with the President on a regular basis. Imagine the head of such an agency trying to shoulder his or her way past Mr. Darmon to gain presidential backing for a management agenda and I think you will see that taking the M out of OMB will probably increase, not decrease, the tendency for the budget process to dominate over management issues. If history has demoralized OMB as a professional management agency -- and I think it has -- then the appropriate thing to do is to try and correct that situation, not to paper over it by creating yet another unit in the presidential bureaucracy. But changing that OMB organizational culture is a long-term proposition and, as the history shows, we cannot be optimistic about the improvements to be expected.

Upgrading the Receivers

The HUD scandal, like other management horror stories in Washington, contains examples of many warning signals that were present but not adequately recognized in the system. There was no reliable way to separate the real signs of trouble from the surrounding informational noise. Congressional oversight was too sporadic to track the emerging pattern of abuse. IG reports from within the department could not realistically haul top HUD management on the carpet. OMB could design and re-design its elaborate management reporting techniques while billions of taxpayer dollars were lost through mismanagement.

The HUD problem is merely the symptom of a deeper incapacity in the system as a whole to sustain critical, long-term attention on executive branch management. As the Deputy Director of OMB said in his testimony of last October 31, that scrutiny needs to become a habit, like brushing your teeth every day. If Congress could find better ways to scrutinize agency management on a regular basis -- what is going right and what is going wrong -- I am convinced this would do much to keep officials on their toes throughout the executive branch. Political appointees and career bureaucrats would find it more difficult to count on Congress's short attention span to conceal management problems. Inspectors General would not be such lonely voices in the departments. The passing parade of OMB political appointees would find it more difficult chop and change management review systems that deteriorate into paper exercises of no use to anyone. The current preoccupation with somewhat abstract policy analyses of programs might be tilted slightly more toward administrative studies of what actually goes on in running these programs. (Recall that the OMB Associate Director responsible for overseeing HUD's budget has testified that for four years her office recommended abolishing the Mod Rehab program solely on the "policy analytic" grounds that this program was not cost effective. But these recommendations, which Congress rejected, were totally innocent of any knowledge about how the Mod Rehab program was actually being managed. As to whether the grants were being responsibly administered, the Associate Director reports, "...I certainly had no knowledge of [that] and I doubt my staff did. It would not be the kind of information that they would have access to.")

Let me conclude by making several general suggestions. While much more thought and investigation will need to be devoted to working out the details, certain principles for designing a more reliable system make sense to me.

First, the management review responsibilities of the General Accounting Office should be substantially increased. On the management front, Congress today is in a position roughly equivalent to the situation it faced on the budget side before the creation of the Congressional Budget Office. Congressmen and their hard-pressed staffs are pelted with torrents of information. There are the semi-annual Inspector Generals' reports, the Financial Integrity Act reports, the annual OMB management report. As Chief Financial Officers are added to more departments, their contribution to the information flow will increase as well. And of course there is also a vast amount of management information already being generated by GAO itself.

Congress needs more help to monitor, sort through and digest this mass of information. The General Accounting Office is the place where congressional committees should look for professional staffwork that regularly prepares non-partisan, straightforward evaluations of management performance in the various agencies. A good beginning has been made with General Management Reports, now 21 in number, that the Management Issues office of GAO has prepared at various intervals over the past decade (coincidentally beginning with HUD). But we need to go farther to create a process whereby GAO routinely tracks and periodically highlights the important management information that Congress needs in order to scrutinize agency operations. What is needed is not yet another elaborate report but a report card process that Congress can use in probing for management weaknesses and in holding officials accountable to achieve improvements. Or, to put it another way, there is at present too much wholesaling of raw management information to Congress; more staffwork is needed for retailing processed evaluations of this information. Doing this will probably require more staff resources at GAO. It will certainly require a more predictable way of organizing the management data GAO has gleaned from the mass of materials and of channeling that information into ongoing Congressional deliberations. Hence my second general conclusion.

Second, each Congressional committee chairman should establish the obligation for all subcommittees to conduct an annual management review of the relevant departments and agencies under their jurisdiction. The starting point for these reviews should be the GAO 'report cards' pulling together the management information (IG reports, FIA reports, etc.) outlined in the preceding point.

Third, each Full Committee should have a senior staff member assigned to serve as the primary point of continuous contact with GAO management evaluations. This person, assigned the role of Mr./Ms. Management for the Full Committee, should coordinate the flow of information for management evaluation, not only to the subcommittees, but also to committee deliberations dealing with authorization, budget appropriations and confirmation hearings for the agency in question.

I believe these steps would go a long way toward creating a more reliable process, a process that would provide both early warnings to safeguard against mismanagement and a forum for constructing and monitoring long-term strategies of management improvement. It would be a process sufficiently independent to call top management to account in ways that Inspectors General may only intimate. All these are laudable goals associated with that old-fashioned term "Good Government." But I think such a process could also fulfill a useful function more directly relevant to Congressmen themselves as elected politicians. Such an ongoing, predictable process of scrutinizing agency management could help shield Congressmen from constituency pressures to intervene inappropriately in the administration of particular project decisions. It could help clarify the boundary between the legitimate representation of constituents' concerns to agency management on the one hand, and policy by influence-peddling on the other. In both executive and legislative branches of government, increasing the risk of exposure can make it easier for people to do what is right.

Senator GRAHAM. Mr. Dean.

STATEMENT OF ALAN DEAN, FORMER SENIOR MANAGEMENT ANALYST AT BUREAU OF THE BUDGET, AND FORMER DEPUTY ASSOCIATE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. DEAN. Mr. Chairman, Dr. Seidman and I do have a brief statement which we deliberately kept short, knowing this would be a seminar discussion, which I will present to the committee.

Mr. Chairman and members of the subcommittee, we are pleased to appear at this important hearing on executive oversight and the role of the Office of Management and Budget in overseeing Federal agencies, and particularly the Department of Housing and Urban Development.

Although both of us are currently fellows of the National Academy of Public Administration, and active in the work in NAPA's standing panel on executive organization and management, we are appearing today as individuals drawing upon long service in the Bureau of the Budget, the Office of Management and Budget which preceded it, and in senior agency positions entailing close relationships with the OMB and the BOB.

We believe that this hearing will establish beyond serious dispute that there's been in recent years a disastrous decline in the capacity of the OMB to exercise meaningful and timely oversight over the quality of management and the integrity of program operations in the executive departments and agencies.

Moreover, we would contend that during the existence of the highly respected Bureau of the Budget and during the first few years of OMB, action would have been taken to strengthen HUD management and thereby reduce the risk of serious deficiencies of the kind that have been revealed in the operations of the Department.

Moreover, the budget division would have closely examined documents such as inspector general reports and would have alerted the Director of the office to abuses or instances of mismanagement.

In short, deficiencies as serious and as diversified as those already revealed in HUD could not have occurred without detection and the launching of corrective measures.

We also believe that the primary purpose of OMB oversight should be the prevention of inept or irresponsible administration through the systematic advancement of good management practices, not the belated locking of barn doors after grave shortcomings have come to public attention.

We will describe briefly recent developments which have led to the erosion of the OMB executive oversight capability and will suggest some things that could be done to restore to the President the capacity to assure that Federal agencies are managed competently.

The Bureau of the Budget from 1939 to 1970 was a highly regarded, professionally competent organization which served the President well and was trusted by the Congress. It was almost entirely staffed by career civil servants who served the Presidency as an institution and helped assure that the machinery of government was well-designed and operated effectively.

The budget function was characterized by the careful review of agency fiscal requirements, and the responsible examiners acquired a detailed awareness of what was happening in each program for which funding was being sought.

During much of the period in which we served in the Bureau of the Budget, only the Director and Deputy Director were appointed on a political basis. Moreover, such distinguished Deputy Directors as Elmer Staats, Roger Jones and Sam Hughes had long service as career officials of the Bureau before their advancement to the deputy post.

During the Eisenhower administration, two noncareer Assistant Director positions were created, but these were not in the line and the incumbents chiefly handled sensitive matters involving close relationships with White House staff and Members of Congress.

The Nixon administration accelerated the process of politicization, which we believe to be at the root in the decline of the effectiveness of the OMB.

By the end of 1988, the number of noncareer appointees had increased to 14, and for the first time, noncareer appointees were put in charge of the Budget Divisions.

These officials, who are now known as Program Associate Directors, or PAD's, formed a layer between the senior career budget staff and the Director. They often lacked knowledge of the Federal budget process, had little understanding of the programs with which they were concerned and rarely stayed around long enough to become truly proficient in their roles.

Increasingly, the OMB has taken on a highly political and often ideological approach to the budget process, which has undermined the quality and integrity of the President's budgets. Career staffs are no longer able to assure that the results of their reviews of agency requirements will have a significant impact on the funding levels approved by the Director.

The ability of OMB budget staff to exercise oversight over agency programs has also been impaired by the enormous workload imposed by chronic budget deficits and the operation of the Gramm-Rudman-Hollings legislation.

This has made it difficult for examiners to spend the time with their agencies which is necessary for the identification of weaknesses in program management.

The OMB responded to this increased workload pressure by reducing staff and by cuts in travel funds. The General Accounting Office in a May 1989 report noted that the Budget staff had declined by 9 percent between 1981 and 1989. The travel budget for examiners was cut 45 percent, so they could not even visit their agencies.

The creation of OMB in 1970 was presented as a reform, designed to increase the emphasis on improving the management of the executive branch beyond the role played in this area by the old Bureau of the Budget.

During the first Nixon term, this objective was successfully pursued under the leadership of an experienced career administrator, Mr. Dwight Ink, from whom this committee has heard.

Unfortunately, the strong staff assembled under Mr. Ink was disbursed at the outset of the second Nixon term, and functions critical to a successful OMB management role were moved to the General Services Administration and to the budget-oriented program associate administrators.

The decline of OMB effectiveness as a center of leadership and oversight in matters of agency management was further accelerated by the politicalization of the senior management staff.

From 1939 to 1972, the leadership of the OMB and BOB management units had been exercised by career civil servants. In this entire period of 33 years, only 5 persons held the principal post charged with improving government organization and management systems—an average of over 6 years per incumbent.

The benefits of this stability were many, including continuity of effort, attainment of expertise, enhancement of institutional memory and the development of excellent relations with agency officials and the concerned committees and Members of Congress.

After Dwight Ink's departure in early 1973, the associate directors for Management have been noncareer, short-term appointees who rarely stayed long enough to have any real impact on how the Government was managed.

In fact, during the 4 years from 1973 to 1977, more persons held the principal management position in OMB than had served in this capacity in the preceding 33 years.

By the time Secretary Pierce took office at HUD in 1981, the management staffing and capabilities at OMB had so deteriorated that it's not surprising that it failed to detect and warn of the serious breakdowns taking place in the Department.

Instead, OMB contributed to the problem by imposing unrealistic personnel ceilings and weakening HUD's capacity to supervise its contractors and clients.

The Congress itself has been so frustrated by OMB responsiveness in management matters that it's approved the creation of new statutory offices in OMB to handle such matters as procurement policy and information and regulatory affairs.

Unfortunately, these well-intended efforts have served only to fragment responsibility and resources in the area of executive branch management.

Panels of the National Academy of Public Administration, which is chartered by Congress to advise on matters relating to government management, have taken note of the steady decline in OMB's management, improvement effectiveness and have proposed a remedy.

What has been recommended is the creation of a separate Office of Federal Management, headed by a director reporting directly to the President. The current OMB would become an Office of Budget or an Office of Budget and Program Review.

The NAPA panels have concluded that the budget function has on the whole crowded out attention to management in the OMB, and they see little hope of improvement under directors burdened with budget deficits and the chronic scarcity of resources to fund approved programs.

The Office of Federal Management could be staffed by persons expert in the organization and administration of government agencies. It could be largely a career organization except for the director and perhaps the deputy. It could be given the resources needed to be effective, and it could develop procedures for tracking agency management in identifying at an early stage breakdowns of the kind which have occurred at HUD.

These are our primary recommendations, Mr. Chairman. Dr. Seidman may wish to supplement these comments and we'd be delighted to stay with you as long as you would wish.

Senator **Graham**. Thank you very much, Mr. Dean. Mr. Seidman.

STATEMENT OF HAROLD SEIDMAN, GUEST SCHOLAR, CENTER FOR THE STUDY OF AMERICAN GOVERNMENT, JOHNS HOPKINS UNIVERSITY, WASHINGTON, DC

Mr. **Seidman**. The statement Mr. Dean has given was for both of us. Based on what I've heard earlier today, there are a couple of comments that I would like to make. One, that I think it was fairly obvious from the testimony of Mr. Diefenderfer and from what I heard in some of the questioning, that, often, there is a tendency to confuse management with controls, or with management improvement projects.

They are not the same thing. There is also an emphasis on auditing. I think, in some respects, our agencies are overaudited. We have inspector generals. We have the GAO. In fact, probably a good deal of the manager's time is spent responding to questions from the auditors rather than doing his or her job.

And I certainly would not concur that one of the things we ought to do is greatly expand the number of people in the OMB who would descend upon the agencies, who would be adding additional auditors. How you would distinguish their functions from the IG's and the GAO, I don't know.

When I was Assistant Director on the management side of the Budget Bureau and with a small staff you could be very effective and, incidentally, one of the things we did, we would work very directly with the committees of Congress; career people were not prohibited from testifying. In fact, I spent a good deal of my time up here and even moved to live on Capitol Hill.

And I think that was a very essential part of the role of being effective. It was preventative to see that you had proper systems installed in the first place. When you discover things on investigation, on audit, it's too late. That's after the fact.

We ought to be doing things so we catch things before the fact. Indeed, one of the roles that I played within the Bureau of the Budget, as Mr. Diefenderfer does, was to sit on the director's review on budgets. I argued against cutting the money for management staffs.

There was always a tendency to do that. You don't get any political reward out of providing money for management. If there's a question of cuts, you take it out of management rather than program.

That has certainly contributed to the HUD scandals because one of the major thrusts of OMB was to promote privatization and contracting out, without recognizing that, when you contract out, you have to maintain within the Government the competence to manage those contracts.

And through the imposition of personnel ceilings, they did not even provide the spaces or the positions to manage the contracts. The contractors were given pretty much of a free hand. If you recall, in another area, the OMB at the same time was telling Federal Savings and Loan Insurance Corporation and the Federal Deposit Insurance Corporation to cut the number of their bank examiners, even though they are not even paid out of the budget. They are paid by the supervised institutions.

So that, as the point I would like to make, is not to confuse management with auditing. It's quite different. The emphasis should be on preventive measures, which don't take the large numbers of people.

What you're talking about here is quality and competence and continuity. Management is something you don't do overnight. It is true, when I was there, I had the problem with the White House of having to have a new product line every year. They had to have what I call management improvement spectaculars.

In my day, we had a war on waste one year. And then we had a cost reduction, and productivity measurement. And we might have achieved something if we kept at it but we had to have something new each year to sell to the White House.

Management improvement is a long-term process. It doesn't yield spectacular results you can point to and it requires sustained effort over a long period of time.

[The complete prepared statement of Harold Seidman and Alan L. Dean follows:]

Statement of Harold Seidman and Alan L. Dean before the HUD Mod/Rebab Investigations Subcommittee of the Senate Committee on Banking, Housing, and Urban Affairs, April 23, 1990.

Mr. Chairman and Members of the Subcommittee:

We are pleased to appear at this important hearing on "Executive Oversight" and the role of the Office of Management and Budget in overseeing Federal agencies, particularly the Department of Housing and Urban Development.

Although both of us are currently fellows of the National Academy of Public Administration and active in the work of NAPA's standing panel on Executive Organization and Management, we are appearing today as individuals drawing upon long service in the Bureau of the Budget, the Office of Management and Budget and in senior agency positions entailing close relationships with the OMB and the predecessor BOB.

We believe that this hearing will establish beyond serious dispute that there has been in recent years a disastrous decline in the capacity of the OMB to exercise meaningful and timely oversight over the quality of management and the integrity of program operations in the executive departments and agencies. Moreover, we would contend that during the existence of the highly respected Bureau of the Budget and during the first few years of OMB, action would have been taken to strengthen HUD management and thereby reduce the risk of serious deficiencies of the kind that have been revealed in the operations of the Department. Moreover, the budget divisions would have closely examined such documents such as inspector general reports and would have alerted the Director to reported abuses or instances of mismanagement. In short deficiencies as serious and as diversified as those already revealed in HUD could not have occurred without detection and the launching of corrective measures.

We also believe that the primary purpose of OMB oversight should be the prevention of inept or irresponsible administration through the systematic advancement of good management practices, not the belated locking of barn doors after grave shortcomings have come to public attention.

We will describe briefly recent developments which have led to the erosion of the OMB executive oversight capability and will suggest some things that could be done to restore to the President the capacity to assure that Federal agencies are managed competently.

The Bureau of the Budget from 1939 to 1970 was a highly regarded, professionally competent organization which served the President well and was trusted by the Congress. It was almost entirely staffed by career civil servants who served the Presidency as an institution and helped assure that the machinery of government was well designed and operated effectively. The budget function was characterized by the careful review of agency fiscal requirements, and the responsible examiners acquired a detailed awareness of what was happening in each program for which funding was being sought.

During much of the period in which we served in the Bureau of the Budget only the Director and Deputy Director were appointed on a political basis. Moreover, such distinguished Deputy Directors as Elmer Staats, Roger Jones and Phillip S. Hughes had long service as career officials of the Bureau before their advancement to the Deputy Post. During the Eisenhower administration two non-career assistant director positions were created, but these were not in the line and the incumbents chiefly handled sensitive matters involving close relationships with White House staff and members of the Congress.

The Nixon Administration, accelerated the process of politicization which we believe to be at the root of the decline in the effectiveness of the OMB, and by the end of 1988 the number of non-career appointees had increased to fourteen. For the first time non-career appointees were put in charge of the budget divisions. These officials, who are now known as Program Associate Directors, or PAD's, formed a layer between the senior career budget staff and the Director. They often lacked knowledge of the Federal budget process, had little understanding of the programs with which they were concerned, and rarely stayed around long enough to become truly proficient in their roles. Increasingly the OMB has taken a highly political and often ideological approach to the budget process which has undermined the quality and integrity of the President's budgets. Career staff are no longer able to assure that the results of their reviews of agency requirements will have a significant impact on the funding levels approved by the Director.

The ability of OMB budget staff to exercise oversight over agency programs has also been impaired by the enormous workload imposed by chronic budget deficits and the operation of the Gramm-Rudman-Hollings legislation. This has made it difficult for examiners to spend the time with their agencies which is necessary for the identification of weaknesses in program management. The OMB has responded to increased work pressures by reducing staff and by cuts in travel funds. General Accounting Office in a May 1989 report noted that the budget staff declined by nine percent between 1981 and 1989. The travel budget for examiners was cut 45 percent.

The creation of the OMB in 1970 was presented as a reform designed to increase the emphasis on improving the management of the executive branch beyond the role played in this area by the Bureau of the Budget. During the first Nixon term this objective was successfully pursued under the leadership of an experienced career administrator, Mr. Dwight Ink. Unfortunately, the strong staff assembled under Mr. Ink was dispersed at the outset of the second Nixon term and functions critical to a successful OMB management role were moved to the General Services Administration and to the budget oriented program associates administrators.

The decline of OMB effectiveness as a center of leadership and oversight in matters of agency management was further accelerated by the politicization of the senior management staff. From 1939 through 1972 the leadership of the OMB-BOB management units had been exercised by career civil servants. In this entire period of 33 years only five persons had held the principal post charged with improving government organization and management systems - an average tenure of over six years per incumbent. The benefits of this stability were many, including continuity of effort, attainment of expertise, enhancement of institutional memory and the development of excellent relations with agency officials and the concerned committees and members of Congress.

After Dwight Ink's departure in early 1973 the associate directors for management have been non-career, short-term appointees who rarely stayed long enough to have any real impact on how the government was managed. In fact, in the four years from 1973 to 1977 more persons held the principal management position in OMB then had served in this capacity during the preceding 33 years.

By the time Secretary Pierce took office at HUD in 1981 the management staffing and capabilities of the OMB had so deteriorated that it is not surprising that it failed to detect and warn of the serious breakdowns taking place in the department. Instead OMB contributed to the problem by imposing unrealistic personnel ceilings and weakening HUD's capacity to supervise its contractors.

The Congress, itself, has been so frustrated by OMB unresponsiveness in management matters that it has approved the creation of new statutory offices in OMB to handle such matters as procurement policy and information and regulatory affairs. Unfortunately, these well intended efforts have served to fragment responsibility and resources in the area of executive branch management.

Panels of the National Academy of Public Administration have taken note of the steady decline of the OMB's management improvement effectiveness and have proposed a remedy. What has been recommended is the creation of a separate Office of Federal Management headed by a director reporting directly to the President. The current OMB would become an Office of the Budget or an Office of Budget and Program Review. The NAPA Panels have concluded that the budget function has on the whole crowded out attention to management in the OMB, and they see little hope of improvement under directors burdened with budget deficits and a chronic scarcity of resources to fund approved programs.

The Office of Federal Management could be staffed by persons expert in the organization and administration of government agencies, it could be largely a career organization except for the Director and perhaps its deputy, it could be given the resources needed for it to be effective, and it could develop procedures for tracking agency management and identifying at an early stage breakdowns of the kind which have occurred at HUD.

This concludes our statement. We would be pleased to respond to any questions which the members of the committee would like us to address.

AD-Stmt/gdp
04/18/90

Senator **Graham**. Thank you very much.

You both have done this to some degree, but I'd like to ask an open-ended question—if you have any further comments that you'd care to make on what you have heard by the first two panels, particularly any areas that you'd recommend that we ought to particularly pursue from what you've heard.

Mr. **Dean**. I'd like to say a word or two about the excellent testimony from Mr. Diefenderfer and Frank Hodsoll. You will note that my statement did not comment specifically on efforts that have been undertaken in the current administration.

The reason it didn't is it is too early to see how much proof there's going to be in this pudding. There are some encouraging developments underway.

For example, initially, Mr. Hodsoll undertook to both concern himself with the National Security budget area and the management side, which doomed attention to management matters.

It's good news that he has recently decided to concentrate his efforts on management. Efforts are also being made to get additional staff, although nothing like the resources that I think are really needed.

On the other hand, as Hugh Heclo pointed out, it is very unlikely that OMB is ever going to be effective in addressing the management problems of agencies in the way Dr. Seidman has described.

Dollars are not usually immediately involved in the slow and difficult process of building agencies so that they work well. And the budget pressures always tend to result in distraction of the leadership of OMB and to lead to the curtailment of the staff available to attend to Government management matters.

And you can't mix budget and management that closely. It sounds like they're part of the same thing; but they're not.

The budget process is deciding the what of the Nation; that is the priorities in the assignment of its resources.

The management side is concerned with making the machinery of Government work, once Government knows what it's going to do.

Even within an executive department you have to organize your management analysis capability separately from your budget shop if you want real performance in the management side.

That's why Dwight Ink, Harold Seidman, Donald Stone, myself, and virtually every other person who has held these senior spots feels that it's just good organizational sense to have an Office of Budget with a budget director concentrating on priorities and program; and also to have a genuine Office of Management made up of people concerned with management who are skilled at it, who will stay with it, will give it continuity of effort and who cannot be diverted because they are institutionally separate, and are reporting directly to the President.

I urge the Congress to support a separate Officer of Federal Management. By the way, Senator Roth sometime ago did have a proposal of this kind in a bill that didn't survive.

The Government Affairs Committee is aware of this proposal. As far back as the Rockefeller Committee in Eisenhower's time, it was concluded that there had to be an organizational split between management and budget in the Executive Office of the President.

As a former OMB official, I made a real effort to see if it would not work to have management and budget together. I found that the only clout that I got from the budget side was on the head, that it was not a mutually supportive activity.

Now coordination will be needed. Hence, they both should be in the Executive Office of the President. They both should be held headed by directors. They do have to communicate. It's all one Government.

This is the major recommendation we would make. Once there is a separate budget shop, I would go a long ways if I were President, which now looks unlikely, to depoliticize the budget function, such as either getting rid of the PAD's or doing something to assure greater continuity of service. As I think Hugh Heclo has suggested, the bane of the recent OMB has bee· the stop and go nature of everything it does, because of the large number of political appointees, the frequency of their turnover and the different assessments they bring to the job as to what are the priorities.

Take Reform 1988, which we have heard about today. Reform 1988 consisted of a half a dozen good projects, most of which were energetically pursued. It wasn't the whole management picture. The person in charge of Reform 1988 disappeared with the change of administration, namely, the very able Jerry Riso. He's now in the private sector.

A new group of people are coming in. I am told reliably that the steam is going out of much of the Reform 1988 effort. We just cannot tolerate that. The Congress cannot tolerate it if there's going to be sustained, reliable, professional, respected attention to how the Government is managed.

Mr. SEIDMAN. I would like to supplement what Mr. Dean said because it's part of the mythology that management needs the clout which it gets out of the budget. I've never found that the clout of the budget was of any assistance. And, indeed, one of the problems is that the management side and the budget side operate on different time cycles.

The time perspective of the budget is a year to year perspective and runs on a 1-year cycle. You cannot deal with management on a 1-year cycle. I've never known any case where we told an agency that if it didn't accept our recommendations on management we were going to cut their budget. In fact, it was quite the reverse, where they agreed to a management reform which resulted in a saving.

The next thing I knew the budget examiner was around to say, "Give us that money back." I said, That's really very helpful.

And, finally, I went to the mat with the director and won. Where an agency achieves savings, at least it ought, with the approval of OMB, to be able to retain some of those savings. You need some incentive in order to get management improvement.

Our important relationship was with the Office of Legislative Reference on Legislative Clearance, not with the budget side. That was the key relationship.

And to comment on Mr. Heclo, I think he observed this from the outside. I can speak from my own experience inside. I had no difficulty at that time of access to the White House. When they found you had competence and knowledge and institutional memory, they used you. You were consulted in developing programs, as I was consulted in developing HUD. And a group was set up to get it organized.

Who did the Secretary come to see when Secretary Weaver was appointed, the first Secretary of HUD? He came to the Budget Bureau to talk to the management people on how to set up and organize his office. A task group in the White House was organized under Bob Wood to advise on that.

There is no capability within OMB today to provide that kind of advice to agencies.

When the Marshall Plan was created, where did they come? They came to the Budget Bureau for advice on how you organize an agency.

I think it's much more important to organize things right in the first place than after the fact.

The other thing was to look at things which we did in the Eisenhower period, in the late 1950's. We pointed out the potential problems within the savings and loan industry, recommending that the FSLIC be separated from the Home Loan Bank Board. We urged also that action be taken with respect to the farm credit banks, who were then lending money at lower interest rates than they were borrowing it.

And President Eisenhower recommended it. I went up with legislation. I must say, the reception I got from the Congress was not exactly enthusiastic. So it takes, as I said, a sustained effort.

I do not like to see further fragmentation of the Government with new agencies, but I think the time has come at least to try a separate Office of Management apart from the Budget because I do not think today it is working, and I do not think it ever will.

Senator **Graham**. Mr. Seidman, you focused on the fact that when you wait for the auditor it is too late——

Mr. **Seidman**. That is right.

Senator **Graham** [continuing]. That you need to be ahead of the power curve and engaged in prevention. I agree with that.

Could you direct us to what you think, either in the Federal Government, in State government, or a complex private sector enterprise, might be a role model of an effective prevention agency or strategy?

Mr. **Seidman**. I think it is hard to point out a single one. It is any one that is doing a good job of initial planning and providing sound advice on how you structure and manage the agencies, which was done certainly in the old Bureau of the Budget. That was one of the major roles, was providing advice. We were not 100 percent effective, nobody ever is. You are never going to assure that there is never going to be a scandal, but you certainly minimize the likelihood.

I think most of your major companies have organizational policy and planning units. They don't confuse it with reorganization like Carter did, which was a mistake. It is, have you organized correctly in the first place? And you will find—and I cannot point out examples, but I think GE had a group that was dealing with an organization and policy planning and it was called TEMPO but my memory may not serve me. Do you remember, Alan? That was Harry Finger's. But any good company does very carefully consider its management structure and how you organize and staff correctly, its role is not limited to oversight in the negative sense of looking at things after they are done.

I might say that one of the problems in dealing with the Congress that I have found, is how power within the Congress is fragmented, and particularly in the House with the number of autonomous subcommittees that you have to deal with. How do you get broad perspective when you have everybody there focusing on a little, narrow piece? It tends to be identified with a particular constituency, so it becomes increasingly difficult to deal with the problems as a whole.

The House Committee on Government Operations, used to have a hearing on every corporation audit report of the GAO. That has not happened in many, many years. Congress does not do anything with the audit reports, either.

Senator **Graham**. Connie.

Senator **Mack**. Thank you, Bob.

Well, I really do appreciate your comments with respect to trying to recognize the difference between internal controls, that concept and auditing and the results of that and the true management skills, and I wonder if maybe you might help me a little bit more. This is maybe just building on Senator Graham's question.

But let's assume for a moment that there was an Office of Management. Give me an idea of what I might expect it to be doing in the kinds of functions and expertise it might entail?

Mr. **Seidman**. Well, one of the—it cuts across a number of areas. One of the problems that happened also in the Office of Management and Budget was breaking up the management side into a lot of pieces. When I was the assistant director, I had responsibility for personnel management, what is now the Office of Federal Procurement Policy, Government Organization Policy and Planning, ADP, and Management Improvement and Research, where I had people going around and seeing what was happening in the industry sector.

Then I would get somebody like Mr. Dean. And tell him, here is something new that Raytheon is doing. We have a management improvement fund. We will give you the money. Will you try this out and see if it works? If it works, then we can try it out elsewhere. In fact, we changed the name from "management improvement," which I always thought was negative, to "management research." One of the things was to find out what was going on in the private sector to keep up to date, to experiment, to import, to be sure that the ideas went back and forth.

I dealt more with the White House on planning and organizating new programs, and advising agency heads on how you structured the agencies.

Senator **Mack**. Planning, organizing, staffing, and controlling.

Mr. **Seidman**. That's right.

Senator **Mack**. That just popped back into my mind. But let me raise this question—go ahead.

Mr. **Dean**. I just wanted to add one thing relevant, Senator Mack, to your point. With respect to the Office of Federal Management and what it would do, it just happens I brought a document of the National Academy of Public Administration which describes the office. It was adopted by the standing Panel on Executive Organization and Management at the time I was chair. I also brought a copy of the Academy's report on "Revitalizing Federal Management," which was the first time the Academy recommended a separate office. I think you will find an interesting discussion here, and a very impressive group of people that sponsored that report.

Basically, the Office of Federal Management would take over what is now in the Office of Procurement Policy, most of the functions relating to data processing and information systems, the bulk of the legislative reference activities, the management of Executive orders, the design of new agencies and departments, the planning of necessary reorganizations, the rendering of advice to Congress and the President on how to approach organizational problems, and the development of agency arrangements in matters of finance and matters relating to management systems generally. The Office would help the agencies achieve a quality of administration that would provide assuance against serious corruption.

I have had the good fortune of serving all 8-years of the once independent Federal Aviation Agency in the capacity of Associate Administrator for Administration. In that 8 year period, not a single scandal affecting the programs or the administration of the FAA ever got outside of the FAA. We found them so quickly they were squelched at an early and non-public stage.

During the 4 years I was in DOT, not a single scandal to my knowledge affected the public transportation complex, large as it was. This was not accidental. Both those agencies were carefully designed from the beginning, and I must say they also had the good luck of top-notch secretaries and administrators.

One other thing I will comment on. There used to be in HUD and elsewhere a key official called the Assistant Secretary for Administration. Dwight Ink once held that position at HUD. I once held that position in DOT. When these offices were occupied by career people with high ethical standards and a thorough knowledge of their agencies, no Secretary, however sleepy, would be kept uninformed of emerging problems. These ASA's, as they were known, they knew virtually everything that went on in their departments, and they made certain that the Secretary or administrator was promptly informed of breakdown or abuses in agency administration.

Then if nothing happened, it was the result of the deliberate decision of the agency head. Not many agency heads were willing to take that risk. We suffer from the lack of that type of career presence in the departments today.

Mr. SEIDMAN. I supplement that, because that was my executive officers' group whom I worked with. Senator Mack, you asked the question for illustrations of the kinds of things we might do. One of the things that Mr. Dean mentioned, we did have the control of the Executive orders of the President, which I can assure you gave us access.

Senator MACK. Say that again? I'm sorry.

Mr. SEIDMAN. All the Executive orders of the President were prepared in the management office, because we were dealing with management issues. The legal issues were under the Department of

Justice. We also were responsible for Budget Bureau circular which set management policies.

President Johnson instructed us in writing, I don't want you people exercising political judgments. There is only one person around here qualified to make political judgments, and that is me! I want you to give what you think is the best advice, not what you think is the political thing to do.

We had problems that came up with the Great Society Programs, and immediately we organized out of the management side teams which consisted of assistant secretaries for administration, people from the Governors' Associations, the counties. I invited the Budget people in but they did not participate. The teams went out in the field to find out what the problems were and to report back. Why were the Governors all complaining? What was going wrong?

The President then organized the Flying Fed's, and we went out with teams and visited every single State of the Union and sat down with every Governor and his staff to find out what the problems were with this program and how you could solve them.

We had the White House support. You don't get that very often. Management is not a high priority with most Presidents, but at least in this case with President Johnson it was.

During the period I was in BOB we were most effective when we were dealing outside the budget framework with the first Hoover Commission, and then during the Eisenhower period I worked mainly with what was the President's Committee on Government Organization chaired by Nelson Rockefeller, of which his brother, Milton Eisenhower, was a member. And I was later a consultant to the Ash Council when that was created.

Usually the leadership was provided by someone other than the Director of the Bureau of the budget who had other priorities.

Senator MACK. I would assume that, again talking about trying to separate these ideas of management and the internal controls' aspects and these various reports that are being done, whether that is FMFIA or whatever, under this arrangement that you have talked about, would you see those reports coming to that organization? Or would you see that going to more again from an accounting standpoint to the Budget side? Or how would you handle that, I guess I should ask.

Mr. SEIDMAN. I would handle that—I read all the audit reports, or the staff did, in their areas, and I think they ought to. I think the budget examiners ought to, too. We did read, and in fact in the Government corporation area for which I had responsibility, I could not have gotten along without using the corporation audits—which were then, I must say, much more indepth than they are today.

Senator MACK. But you would see those coming into this Office of Management, then, for review?

Mr. SEIDMAN. Yes. And we did have the lead in testifying before the Government Operations Committee on the audit reports. But I think the Budget examiners also ought to follow up. Actually, there is a procedure which says that there is supposed to be an orderly process by which the Budget examiners review every GAO audit report, unless they have changed the rules at OMB.

Mr. **Dean**. I would say, Mr. Mack, that if the Office of Budget does a first-rate job in advising the President of what the program funding level should be, and if the examiners are able to penetrate the real requirements of programs and arrive at sound decisions on funding needs, that is a tremendous undertaking. Assuring that the machinery of government is functioning, that it works well, and that it is enforcing accountability, are matters best handled in a management framework.

Japan has an office of Administrative Reform in the Prime Minister's office. It not part of the Ministry of Finance. I can't think of a major country today that still combines the work on improvement of government machinery with its budget office.

Senator **Mack**. Thank you, very much. I am going to have to leave.

Senator **Graham**. You will not be leaving much before the meeting is over.

Mr. Dean, you alluded to the reports of the National Academy for Public Administration. I do not know the length of those reports, but at least the legislative recommendation and the executive summary I would like to suggest be made part of the record of this hearing.

Mr. **Dean**. We would be delighted, Senator.

Senator **Graham**. Senator Mack was asking earlier about what would be some analogies to the Federal Government, and I have been thinking about the question. At this point, my best answer to that question is a complex conglomerate of enormous scale, and maybe there is no entity which has the complexity that ranges from the U.S. Navy to the Forestry Service to a health provider, and certainly not of the scale, but let us take an entity like Berkshire- Hathaway, Mr. Warren Buffett's conglomerate. It operates a diversity of activities, each of which has a high degree of autonomy, but there is a central core which is responsible for overseeing that each of those individual entities is moving toward its business objectives and is being managed and controlled with a sufficient degree of central direction that it will contribute towards the success of the overall enterprise.

Do you think that that is an appropriate institutional analogy? And if so, then I would like to use it to ask some further questions.

Mr. **Dean**. Unfortunately, your case is much more analogous to the U.S. Department of Transportation, a large holding company department with highly diversified missions, than it is to the entire Government of the United States. Nonetheless, there is much to be learned from large-scale industrial experience.

I will give you one example before you pursue your question. Namely, decentralization. We spend a lot of time talking today about controls, but the way you get effective functioning in the private sector or in the Government is to let managers manage. We should make darn sure that they have the requisite authority, the requisite resources, and the right people, and then let them within that framework do the job.

Controls should comphasize the subsequent verification that this stewardship has in fact been faithfully carried out; so that if failure occurs, then something happens and happens quickly. Every successful large conglomerate in the private sector of which I am aware has operated on a highly decentralized basis with a relatively small corporate headquarters that did not try to micromanage the day-to-day work as long as profitability, adherence to good public and corporate policy and financial guidelines were being observed.

Mr. **Seidman**. I might say that in looking at industrial experience, the most successful companies today have almost all moved toward a much flatter type of organization structure, not layers of people auditing, second-guessing, reviewing, less hierarchial, less bureaucratic, more flexible structures.

The old Budget Bureau did operate that way. Today the Budget OMB is a very hierarchial organization. The career people only can talk to their immediate superior, or at least that is what they tell me, and they talk to the next person in line, and they do not have direct access into the White House or the people who are making the policy decisions.

Now there are some lessons that can be learned. DuPont used to maintain a room where they had simple displays to be used in for judging how effectively each of the divisions of the company was operating. I might say that on the management side IT&T went to my staff for a person who became later president and executive vice president of IT&T, so the kind of training they received within the management staff of the old Bureau of the Budget seemed to be transferrable to the private sector.

Senator **Graham**. One of the differences between a corporation and the Federal Government is that there is essentially a unity of purpose and a rather agreed upon standard of measurement of success in realizing that purpose, generally an annual financial report. In any government, you have divisions of purpose.

I do not think it is uncharitable or historically unfair to say that President Reagan ran for the Presidency essentially as an "anti-government President." So he started with a basic questioning of the role of Government in our society, and then there were specific programs that he identified as being inappropriate for Federal involvement, including many of the programs within the Department of HUD.

The Congress continued to be supporters of those programs. So you had a division which is probably not paralleled in any successful private-sector venture. From that statement of the political realities which I think became heightened in what happened within HUD, what recommendations would you make for the Congress in terms of how we should function in terms of facilitating a flat, effective organizational structure?

Mr. **Dean**. Mr. Chairman, the ability of the Congress to administer the executive branch is limited, and as I know you find it, often frustrating. This is particularly true of areas like organizational and bureaucratic design. But you do have an option we have already mentioned. You can push hard to see that there is an institution somewhere in the Government that is knowledgeable in management, is not spending all of its time crunching numbers to meet the latest budget targets. If you can create that kind of office, and if whatever committee has jurisdiction over the hearings on the director assures that there is in fact an experienced and competent person in charge, and if then the Appropriations Committee assures that reasonable resources are made available, if the office is close to the President, where it should be—he is the Chief Executive, then there can be a center for the kind of know-how and ability to push modern management concepts that you feel and we feel are so important.

Senator **GRAHAM**. In the Florida Legislature in which I served for 12 years, we created an office that we called the Joint Legislative Auditing Committee, which was intended to be the institution's capability to see that the executive responded in an appropriate manner.

One concern I have is with the fragmentation of the Congress, as you have indicated, you could end up with an agency having Mr. Bennett's problem as the coordinator of the drug program in which he says he reports to 90 different committees or subcommittees.

Do you think that, looking at the congressional side of the organization, that we have within our current system the capability of pushing the executive to reform itself? Or do we need to have a different organizational structure?

Mr. **SEIDMAN**. I think I can speak to this, because you have the problem with the Congress that is somewhat comparable to that in the executive branch. That is, the role of the Government Affairs Committee and the Government Operations Committee in the House, which have always been relatively weak committees.

They are the ones who are supposed to be looking at the broader picture. The individual committees are dealing with the problems of their constituency. They are interested in what serves the interest of the people who are represented by that committee or subcommittee, and they are not looking at the broader picture.

I did serve briefly as a consultant to the Senate Committee on Government Operations. I tried to interest the chairman in dealing with some of these broader issues. I even wrote a good speech for him which he gave, but it was very hard to interest him in dealing with and tackling these broader issues.

I think institutionally a stronger role should be given to the House Committee on Government Operations and the Senate Government Affairs Committee, in reviewing legislation in the area of organization and management of government programs. I think somebody who was a little more sophisticated about organization structure would never have approved the jerry built structure to bailout the savings and loans.

We need to strengthen the role of the committees which have the across-the-board jurisdiction within the structure of the Congress.

Mr. **DEAN**. I think that is sound, but those committees have to deal with the more generic questions. They can worry about things like the quality of a director of Federal management. They can address things like accounting systems and so on that cut across the Government.

Since you asked the question, I do think that it would help if the jurisdictions of the substantive committees could be made more consistent with actual agency boundaries as they now exist. This could greatly aid the Congress in exercising oversight.

When I was in the FAA we dealt with only one substantive committee in the House, and one in the Senate. They knew a lot about us, and we knew a lot about them. The relationships were superb.

When DOT was set up, and when we subsequently picked up HUD's urban mass transportation program, we found ourselves reporting to several different committees. For example, the committee that had jurisdiction over mass transt when it was in HUD kept it. By the time we were through, we had 5 committees worrying about the U.S. Department of Transportation. We found ourselves in a position where there was no single transportation committee. There are a couple with transportation in their names, but they did not have a parallel jurisdiction.

Even the Agriculture Department reports to 8 committees.

Mr. **SEIDMAN**. There is another point which I think is worth making because we have talked about the problems of OMB. I have seen it frankly in what has happened to the staff of the Congress. It was very much different in my day. One, the staff were smaller in number. They were more experienced. They had been around. You had greater continuity. You did not have all the subcommittees with the turf battles between subcommittee staff—and I must say, while we still have some old hands around, we certainly at that time had congressional staff who knew more about the agencies than the head of that agency did.

You had experience and competence within the staff with whom we were able to deal. They were smaller in number, so we all had more work to do than we could do, so we were very happy to share it. And we had close working relationships, incidentally, between the Budget Bureau and the committees of the Congress, which I think was very essential. But that depended upon continuity of staff and to a degree the experience of the staff.

Senator **GRAHAM**. Your last comment, Mr. Seidman, raises my last question.

From the first panel we heard a lot of discussion about the difficulty of attracting quality people to the Federal Service. Each of you has had a long history of involvement with the Federal Government. Do you think that it is more difficult today to attract quality people than it was 20 or 30 years ago? And if so, why is it more difficult? And are there any prescriptions that you would recommend?

Mr. **SEIDMAN**. I think it is more difficult because of the general atmosphere where you have Presidents who say that working for the Government is not something anybody ought to really want to do; that the Government does not solve problems, it is the cause of problems; and the worst thing that can happen to you is if somebody says I am here from the Federal Government and I am here to help you.

This creates an atmosphere which does not encourage people to enter public service. I went into the public service because I came frankly out of a family that was interested in Government. I went through a school where we were taught it was our duty to perform public service.

Besides—Senator Mack isn't here—I thought it was a lot more interesting and exciting than being in the family occupations which were law and banking. I used to sit through big corporate mergers in my father's office. I said, I don't want to do this. This seems very boring. I think public service is more interesting and challenging.

And I found a number of people who in my day came back into Government from very important jobs within industry who said they were bored, including Elmer Staats. His wife told me one day he came back from Marshall Fields and he said, "I'm not going to spend the rest of my life selling brassieres." [Laughter.]

It is more difficult, but I think there is a challenge and an opportunity. I do not think it is entirely a matter of pay. Pay is somewhat significant, but I think there are other factors. It is a matter of pride and how you are regarded by your peers, of how you appear within the public, and indeed an opportunity get a job done. And with the career service today, that is one of the problems.

As you layer on political appointees, you have people for whom you work for whom you do not have much respect or confidence, which I think has been identified as a major problem. You do not have access. I got a Presidential appointment when I was still about a grade 14 by President Truman. I always brought my staff to the White House with me, because that was very important I thought in terms of their development.

These are the kinds of things which will attract people to the public service. One is an opportunity to get something done, to see the results of what they do, and to have some respect.

Mr. DEAN. Mr. Chairman, I do not know whether you were aiming your question primarily at the top policy appointees or the career civil service, or both, but I have only two or three brief comments I would make.

Yes, it is a little more difficult now. One of the main reasons is that people of real ability come to enterprises that they think are meaningful to their lives and the lives of other people. To do that, government itself has got to be respected.

As you pointed out, President Reagan ran against Government. President Carter ran against the Government. President Bush is much more muted on that issue, I am delighted to see. But as a civil servant, the kind of call that President Kennedy issued, even though he served only a short period of time, energized me and others like me. There are so many exciting things in Government to do that you can get good people for the civil service appointments if Government is presented to them as an important part of America and its success.

At the political level, it is a little different. I think some of the limitations and requirements relating to postcareer activity, disclosures, and ethics in Government, worthy though they are, have cumulatively made it hard for many people to accept the relatively short tenures of top government officials.

I think the main problem is the White House Personnel Office. With all due candor, the impression that most people, including many high-level officials of the current administration have, is that the main goal of that Office is to find spots for campaign workers and campaign contributors. Whatever they may be saying about looking for "merit," I can give example after example where even top agency officials could not get deputies, whom they had identified and who were highly qualified, appointed because the White House Personnel Office was touting somebody unacceptable to the head of the agency. That happens all over the Government.

There are many people in the United States who would welcome an opportunity to serve who are, since this is currently a Republican administration, certainly not strong opponents of the administration's policies. But if the rewards are given out, as Mr. Ink said in his testimony last Friday, on a patronage basis rather than trying to find policy officials who agree with the President but bring real ability to the job, then you are going to have trouble staffing the top officers.

And Mr. Pierce, I am afraid, was kind of one of the examples.

Mr. **Seidman**. There is one other element that I should mention. When I came into the Bureau of the Budget, one of its functions was to identify and spot "comers," "high fliers" within the Federal Service. If OMB is looking for people they ought not only to look at the business school, they ought to look for talent within the Government itself.

It was not something the Civil Service Commission could do. It had to be neutral. One of the functions that was performed in promoting good management was that the heads of agencies, the new appointees, would come to the Budget Bureau and say, "Do you know any good, young talent that is coming up in the agencies whom we might get?"

That is a very important function. It was discontinued later on as one of the, again, economies imposed by the Budget director who did not know why we were spending money doing this. There is a lot of talent within the Government today. The PMI Program, the Presidential Management Intern Program, has brought in a lot. I have known a number of them, including some of my former students, who have been first-rate, who have gone up and have done very well.

They are very talented. So under the right circumstances and providing the environment, and particularly a job that is challenging and where they can do something, we can get them.

Senator **Graham**. Well, gentlemen, thank you very much. I know you have devoted most of the afternoon to this hearing, and I am very appreciative of your very extremely thoughtful and contributing recommendations.

Mr. **Dean**. We enjoyed it, Mr. Chairman.

Mr. **Seidman**. Thank you.

Senator **Graham**. Thank you, very much.

[Whereupon, at 6 p.m., the hearing was adjourned.]

[Additional material supplied for the record follows:]

DONALD W. RIEGLE, JR., MICHIGAN, CHAIRMAN

ALAN CRANSTON, CALIFORNIA
PAUL S. SARBANES, MARYLAND
CHRISTOPHER J. DODD, CONNECTICUT
ALAN J. DIXON, ILLINOIS
JIM SASSER, TENNESSEE
TERRY SANFORD, NORTH CAROLINA
RICHARD C. SHELBY, ALABAMA
BOB GRAHAM, FLORIDA
TIMOTHY E. WIRTH, COLORADO
JOHN F. KERRY, MASSACHUSETTS
RICHARD H. BRYAN, NEVADA

JAKE GARN, UTAH
JOHN HEINZ, PENNSYLVANIA
ALFONSE M. D'AMATO, NEW YORK
PHIL GRAMM, TEXAS
CHRISTOPHER S. BOND, MISSOURI
CONNIE MACK, FLORIDA
WILLIAM V. ROTH, JR., DELAWARE
NANCY LANDON KASSEBAUM, KANSAS
LARRY PRESSLER, SOUTH DAKOTA

STEVEN B. HARRIS, STAFF DIRECTOR AND CHIEF COUNSEL
LAMAR SMITH, REPUBLICAN STAFF DIRECTOR AND ECONOMIST

United States Senate
COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS
WASHINGTON, DC 20510-6075

May 1, 1990

The Honorable William Diefenderfer III
Deputy Director
Office of Management and Budget
Old Executive Office Building
Washington, D.C. 20503

Dear Mr. Diefenderfer:

I would like to thank you and Mr. Hodsoll for testifying at our subcommittee hearing on April 23. I also appreciate the efforts of your career staff in preparing you for that hearing.

We are interested in obtaining the following additional information relating to your April 23 testimony:

(1) SECTION 235 REFINANCING

One issue discussed during our hearing was OMB's rationale in rejecting a proposal by HUD to refinance Section 235 mortgages. At that hearing, OMB presented a cost benefit analysis of the refinancing proposal. Our staff was not aware that such an analysis existed, despite the fact that we had requested previously all OMB documentation regarding the issue.

Consequently, I would like to reiterate our request that all OMB internal memoranda, correspondence, written analyses, and other documentation regarding this issue be sent to our subcommittee. In addition, you will find attached to this letter a series of additional questions relating to this issue.

(2) FMFIA PROCESS

During your testimony, you stated that "OMB will make needed changes in the FMFIA process to ensure that the agencies focus on program management as well as administrative management." (unofficial transcript p. 95) Could you list each change you intend to make and the timetable for implementing each change?

(3) MANAGEMENT AND BUDGET COORDINATION

During your testimony, you stated that "we have developed a coordination where we also have the budget side looking at management issues." (unofficial transcript p. 95) Could you explain how you have coordinated or plan to coordinate the budget functions with management functions?

The Honorable William Diefenderfer III
Office of Management and Budget
May 1, 1990, Page 2

(4) ILLUMINATING DATA

At the hearing, you agreed to compile and provide certain data which you feel could be good indicators of the condition of HUD and useful to our oversight functions. You mentioned that a list of such data could be compiled within 30 days. (unofficial transcript p. 136-37) I would like to reaffirm our interest in obtaining such data.

In the interest of completing our work on a final report, we need responses to these additional requests by May 18. Please call John Brandolino at 224-5494 if you have any questions.

Sincerely,

Bob Graham
Chairman
HUD Investigation
Subcommittee

Enclosure

ATTACHMENT ATTACHMENT

Section 235

Please provide copies of all documentation, if any, which support your answers to the following questions.

1. Mr. Diefenderfer's testimony focused on OMB's reaction to the IG's refinancing proposal made to the Secretary in 1987. However, HUD first proposed refinancing in 1983 with its 1985 budget submission to OMB. OMB rejected this idea in 1983 as well. Why?

2. During questioning by the Chairman regarding OMB's reasons for rejecting HUD's proposal to refinance Section 235 mortgages, Mr. Diefenderfer stated that HUD career staff was opposed to the idea because it was an inefficient program and it did not provide the required benefits and services. Who at HUD was recommending against this? What evidence, if any, does OMB have which supports HUD's assertion that the program was, in fact, inefficient?

3. In explaining why OMB opposed refinancing in 1987, Mr. Diefenderfer stated that OMB did not believe the Congress would rescind the budget authority for the program thereby allowing the savings from refinancing to be used for new program activity. In 1987 Representative Kleczka introduced HR 3281 which called for refinancing and rescission of the budget authority, yet OMB opposed this legislation. Why?

4. Mr. Diefenderfer testified that OMB staff made their judgments about refinancing on a purely analytical basis. However, a 1987 OMB memorandum to Deputy Director, Joseph Wright, recommended against refinancing because it could be politically unpopular to the general public. Based on your testimony, how do you account for a seemingly political analysis of this proposal and not a purely analytical one?

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

May 21, 1990

Honorable Bob Graham
Chairman, HUD Investigation Subcommittee
Committee on Banking, Housing,
  and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

I am pleased to respond to your May 1 request for additional information relating to my April 23 testimony before the Subcommittee.

Section 235 Refinancing

I have already sent you a copy of the cost-benefit analysis of the Section 235 refinancing proposals I had OMB staff prepare for my April 1990 testimony. Enclosure 1 contains that document, together with the other documents we had previously provided your Subcommittee on the 1983 and 1987 refinancing proposals.

To make doubly sure that all documents have been provided to the Subcommittee, I asked staff to check all files, to have several staff do the checking, and to do a careful review for all documents relevant to your requests. As we understand your previous and current requests, they include all documents from 1983 through 1987 on the 235 refinancing proposal.

This staff review yielded five documents in addition to those provided previously, two HUD documents from 1983, two 1987 HUD Inspector General letters to OMB, and a one-page OMB table from 1983. The two 1983 HUD internal documents are a legal analysis of several issues and a preliminary cost analysis of the HUD proposal. The two 1987 HUD I.G. letters to OMB provide a status report on the I.G.'s recommendation, and an update on the Kleczka proposal. (These I.G. letters are in addition to the two 1987 I.G. letters previously provided.) We earlier provided to the Subcommittee a one-page 1983 OMB analysis of the HUD proposal. When checking all of our files for documents, we found additional copies of this document with a one-page outlay comparison table attached. A copy of the document with the table attached is enclosed. All of these documents are provided in Enclosure 1.

Responses to your specific questions on Section 235 refinancing are provided in Enclosure 2.

FMFIA Process

As part of an overall effort to improve the FMFIA process, OMB has several initiatives underway to ensure that agencies focus on program management as well as administrative management. Over the next few months, OMB will issue policy guidance to the agencies that will strengthen the reporting requirements for high risk areas, call for increased involvement of senior management officials in the FMFIA process, and require that correction of major management problems be addressed in agency budget requests.

Management and Budget Coordination

The Management and Budget sides of OMB have been given clear direction to coordinate their activities in order to ensure more effective management of Federal programs. This is being accomplished by joint Management/Budget attendance at management meetings, including meetings I have held with Assistant Secretaries for Management. We have also provided for routine routing of correspondence on management issues through the budget examiners, integration of management priorities into budget preparation guidance, and joint Management/Budget efforts to improve the budget execution process. The results obtained to date from these efforts are encouraging. The high risk list, for example, was the result of collaboration among the agencies, the Budget side, and the Management side. Followup to ensure appropriate corrective actions is being pursued in the same collaborative manner.

Illuminating Data

Enclosure 3 presents eight proposed performance indicators that we believe would be good barometers of the condition of HUD housing programs and therefore useful to your Subcommittee's oversight functions. These performance indicators may prove equally useful in measuring the condition of housing assistance programs administered by the Department of Veterans Affairs and the Farmers Home Administration. Over the next several weeks, we will be discussing the performance indicators with those agencies, as well as with HUD and your Subcommittee staff. It is our intention to finalize the performance indicators and propose a reporting system by the end of this month.

I hope this information will be useful to you and the Subcommittee. I look forward to working with you to improve credit management in housing programs.

Cordially,

William M. Diefenderfer III
Deputy Director

Enclosure 2

Section 235 Refinancing

The following are answers to the additional questions submitted by Senator Graham.

1. Q. Mr. Diefenderfer's testimony focused on OMB's reaction to the IG's refinancing proposal made to the Secretary in 1987. However, HUD first proposed refinancing in 1983 with its 1985 budget submission to OMB. OMB rejected this idea in 1983 as well. Why?

A. In the Department's Fiscal Year 1985 budget submission transmitted in September 1983, HUD proposed to refinance Section 235 mortgages with high interest rates. This proposal included legislation (which was not submitted to OMB for review) and a request for a $44 million appropriation to pay mortgage origination points and closing costs on behalf of Section 235 assisted homeowners who agreed to refinance their mortgages at lower interest rates.

During the formulation of the President's 1985 budget, OMB staff recommended that HUD's request to refinance Section 235 mortgages be denied. This recommendation was based on the following reasons:

1) The initial budgetary impact to cover the costs of refinancing and offer some sort of incentive for current mortgagors would be substantial.

2) OMB staff strongly believed that Congress would not rescind recaptured subsidy funds but would, instead, use them for new program activity:

   o Many members of Congress had found this to be a very popular program and had consistently proposed restarting it.

   o The budget authority that would be released had already been scored against budget resolutions in prior years. Therefore, reuse of the funds would not count against the current Section 302 allocations.

Even though the Director accepted the OMB staff recommendation, the formal OMB "passback" to HUD provided no decision on the Section 235 proposal. The proposal was not submitted by the Administration in the 1985 budget, so it is assumed that the decision not to propose it was transmitted orally at some point during budget negotiations.

2. **Q. During questioning by the Chairman regarding OMB's reasons for rejecting HUD's proposal to refinance Section 235 mortgages, Mr. Diefenderfer stated that HUD career staff was opposed to the idea because it was an inefficient program and it did not provide the required benefits and services. Who at HUD was recommending against this? What evidence, if any, does OMB have which supports HUD's assertion that the program was, in fact, inefficient?**

   A. In 1983 HUD did support such a proposal by including a Section 235 refinancing request in their Fiscal Year 1985 budget submission to OMB. While this proposal was discussed during the development of subsequent budgets in the Department, OMB did not receive any further refinancing proposal approved by the Secretary. Staff in HUD's Office of Housing and Office of Administration had substantial concerns about obstacles to refinancing or were doubtful that savings would actually happen. One source documenting problems with program effectiveness and efficiency may stem from a report titled, "Housing in the Seventies." Another source could be a 1979 internal HUD report showing that cumulative defaults through December 1978 for the Section 235 program stood at nearly 20 percent, a rate substantially higher than HUD's Section 203(b) program. The reports were based on activity in the original Section 235 program. Attached are summaries of both reports.

3. Q. In explaining why OMB opposed refinancing in 1987, Mr. Diefenderfer stated that OMB did not believe the Congress would rescind the budget authority for the program thereby allowing the savings from refinancing to be used for new program activity. In 1987 Representative Kleczka introduced H.R. 3281 which called for refinancing and rescission of the budget authority, yet OMB opposed this legislation. Why?

   A. In September 1987, Rep. Kleczka submitted legislation for refinancing Section 235 mortgages that also required rescission of recaptures. No formal OMB position on the legislation was ever issued, nor did OMB career staff informally discuss the legislation with Congressional staff. In early October 1987, OMB staff did convey to HUD's Inspector General that the Administration would continue its policy not to support the IG's proposal to refinance Section 235 mortgages. The Administration was concerned that such a proposal would likely not result in savings but, instead, would result in additional Section 235 loan activity.

4. Q. Mr. Diefenderfer testified that OMB staff made their judgments about refinancing on a purely analytical basis. However, a 1987 OMB memorandum to Deputy Director, Joseph Wright, recommended against refinancing because it could be politically unpopular to the general public. Based on your testimony, how do you account for a seemingly political analysis of this proposal and not a purely analytical one?

A. A March 1987 internal memorandum to OMB's Deputy Director laid out three reasons why OMB staff felt HUD's IG refinancing proposal was not a good idea. Those reasons were the following:

1) HUD would pay up-front closing and refinancing costs as well as a possible "sweetener" to induce households to refinance, resulting in a large initial budget outlay.

2) It could raise an equity issue and, thus, increase demand for subsidizing the refinancing costs of high-interest rate government-insured mortgages for other than those holding Section 235 loans. Paying refinancing costs for moderate income homeowners with Section 235 mortgages while not offering similar payments for moderate income homeowners with unsubsidized but high interest rate FHA-insured mortgages creates an economic equity issue. Acknowledging the broad support for homeownership programs generally and the budgetary risks from raising an economic equity issue in this area does not constitute "political analysis." Finally, OMB staff never recommended against the refinancing proposal "because it could be politically unpopular to the general public."

3) There was no guarantee that Congress would rescind recaptured funds and produce savings to the Federal government. The broad political support for, or political popularity of, HUD homeownership programs was one reason for the OMB staff assessment that a rescission was unlikely. In addition, from the standpoint of Congress, deobligated or recaptured funds are a 'free' resource:

- o The budget authority has already been 'scored' against budget resolutions in prior years and, therefore, specification of the reuse of deobligated funds by either the authorizing or appropriating committees does not count against their current Section 302 allocations.
- o There is no need for any outlay offset either, because the present subsidy expenditures on behalf of the high rate mortgages are already factored into the baseline.

Finally, Congressional action up to then had suggested that recaptures would not be rescinded. The President's budget had routinely proposed appropriation language that would automatically rescind Section 235 deobligations, but the appropriations committees had not gone along with this for several years. Moreover, the House Banking Committee bill pending at that time, H.R. 4, would have required that deobligated funds be used for new subsidy contracts.

DRAFT

Enclosure 3

Performance Indicators for Housing Programs

Eight performance indicators for housing programs, falling into two general categories, have been identified. The two categories are: (1) economic indicators; and (2) measures of portfolio credit quality. Both types of indicators should be monitored because major loan losses are a function of both changes in the economy and inherent credit risk.

ECONOMIC VARIABLES

Although lax credit underwriting standards and outright fraud are responsible for significant program losses, adverse changes in certain economic variables impact credit programs more severely. The following indicators are listed in descending order of importance:

Home Price Appreciation

The rate of home price appreciation is extremely important as a variable because of its effect on borrower equity. Rising home prices increase borrowers' equity, thereby increasing the probability that borrowers in financial distress sell their home for a profit rather than default. Declining home prices reduce borrowers' equity, thereby increasing the expected default rate, and also reducing agency proceeds from the sale of foreclosed properties.

Housing price data are available from the Census Bureau, which publishes the Constant Quality Index of Housing Inflation on a quarterly basis for four regions and twelve subregions. The National Association of Realtors also provides quarterly regional data on the average sales prices of existing single-family houses, though these data are a less precise measure of true housing inflation. OMB and the housing credit agencies can, therefore, receive the most relevant data given the geographical distribution of loan portfolios being monitored.

Mortgage Interest rates

Mortgage interest rates are a key factor in determining the solvency of housing credit programs because they affect credit risk and interest rate risk. Credit risk is affected because mortgages with high coupons are at greater risk of defaulting when interest rates fall for the same reason refinancings surge: people paying on high interest, expensive debt seek to unload it when interest rates fall. Those with equity in their houses tend to refinance their mortgages when rates fall. Those without equity cannot refinance, and are much more likely to default when

DRAFT

rates fall, because they are effectively paying very high rent for their dwelling. This phenomenon explains the surge in defaults in the mid-1980s on high coupon mortgages from the early 1980s, and is a key factor in FHA's current problems.

Agencies that hold large portfolios of direct loans are exposed to interest rate risk in that their long term, fixed rate loans are usually financed with short term Treasury borrowing. Consequently, if interest rates rise, then the negative spread (from originating subsidized loans) between lending and borrowing rates widens, thereby reducing the market value of agency equity. Depending upon the severity of their losses, agencies might require supplemental appropriations in order to maintain the same level of direct loan outlays.

The Federal Housing Finance Board provides quarterly data on national average interest rates for both fixed rate and adjustable rate mortgage loans. These interest rate data are also available for various loan-to-value ratios.

Level of Employment

The level of employment affects the income of a wide class of borrowers and, hence, their ability to repay loans. It also affects the ability of a market to sustain home prices and, thus, equity levels. Other things being equal, rising levels of employment will reduce loan losses. For purposes of analysis, the level of employment is preferable to the unemployment rate because, even if the latter remains constant, housing prices will drop (and foreclosures increase) if the level of employment declines -- as may occur during a population decline.

National, regional, and State levels of employment are available quarterly from the Bureau of Labor Statistics.

Composite Index of Leading Indicators

The Bureau of Economic Analysis' index is designed to predict monthly movements in aggregate economic activity (i.e., income, production, employment, and trade). Viewed simply, this indicator is a measure of the strength of the American economy. Other things being equal, loan losses will be relatively low during business cycle peaks and fairly high during business cycle troughs.
Consequently, successive, significant declines in the index are a precursor to higher loan losses, while multiple gains in the index indicate lower future loan losses.

DRAFT

PORTFOLIO CREDIT QUALITY VARIABLES

The portfolio credit quality indicators selected apply to different stages of the credit cycle. The loan-to-value ratio, for example, is a "front-end" indicator that reflects changes in credit underwriting standards; as such, it provides early-warning of deterioration in portfolio credit quality. Other "back-end" indicators -- such as the default rate -- assess portfolio performance at the loan management stage, and provide what might be termed as "late-warning" of impending losses.

Median Loan-to-Value Ratio

Among portfolio strength variables, the LTV ratio is by far the most significant. The loan-to-value ratio for housing loans represents the loan amount as a percentage of the appraised value of the property being financed. As the initial LTV ratio rises, the borrower's downpayment percentage (and equity) decrease, thereby greatly increasing the probability of default in the event of financial hardship. For example, HUD mortgages with LTVs of 97% are twice as likely to default as loans with LTVs of 95%. OMB and credit agencies should, therefore, monitor direct and guaranteed loan portfolios for significant increases in the median LTV ratio. Some agencies, including HUD, currently track this data.

90-day Delinquency Rate

Because delinquencies are the first actual sign of loan problems, there is a high correlation between the delinquency rate and eventual loan losses. If the delinquency rate increases significantly from historical averages, then it is likely that future loan losses will also increase markedly. For FHA and VA-guaranteed loans, these data are published quarterly for each state by the Mortgage Bankers Association of America in its National Delinquency Survey.

Default or Claim Rate

The default rate for a program is directly correlated to its loan losses and income for the current year. Default information by state is available quarterly from the Mortgage Bankers Association. The credit agencies also track these data on a quarterly basis.

DRAFT

Average Loss Ratio on Sales of Foreclosed Properties

When credit agencies sell foreclosed properties, they typically receive as proceeds only a fraction (e.g., 60%) of the initial appraised value. The amount lost (40%) is the loss ratio. Some credit agencies, including HUD, currently track this data on a quarterly basis.

Once key early warning indicators have been identified by the Federal Credit Policy Working Group, OMB's role will include the following: 1) providing the credit agencies with consistent and timely economic data; 2) advising agencies how to interpret and use the economic and program data to anticipate trends in portfolio performance; and 3) working with HUD and FMS to develop a trial early warning report for housing credit.

DRAFT

PERFORMANCE INDICATORS FOR HOUSING CREDIT PROGRAMS

QUARTERLY INDICATOR SCORING SHEET
FOR THE QUARTER ENDING JUNE 30, 1990

	Base 12/31/89	Quarter Change			Annual Change		Total Change	
		Prior Quarter	Last Quarter	% Chg	Year Ago	% Chg	Cumulative	% Chg to Base
Economic Indicators:								
Average sales prices of single-family homes								
Composite Index of leading indicators								
Level of employment								
Mortgage interest rates								
Adjustable rate								
Fixed rate								
Credit Quality Indicators:								
Median loan-to-value ratio								
90-day delinquency rate								
Default (or claim) rate								
Average Loss Ratio								

Testimony of Dwight Ink
President, Institute of Public Administration
for the
HUD Investigative Subcommittee

April 23, 1990

I appreciate the opportunity to appear at your hearings entitled "Executive Oversight" which will focus on the role of OMB in overseeing federal agencies. This is a subject of considerable interest to me since I was the last person to head the management effort in the Bureau of the Budget and the first to head the management effort in the new OMB. I commend your Committee for addressing this issue which has been largely ignored by successive White Houses and Congress, with the exception of the Senate Governmental Affairs Committee.

I understand you are interested in hearing some history that might be useful in assessing the current management status of OMB.

In the middle 1960's, several of us were recommending the establishment of an Office of Executive Management (OEM) within the Bureau of the Budget. We urged this reorganization step because of the view that the management activities within the Bureau of the Budget were having increasing difficulty competing for attention of BOB leadership as the budget issues were becoming more and more time consuming.

The establishment of this unit did, in fact, provide help in providing greater visibility for the management responsibilities of the Bureau of the Budget, a feature which had been extremely important at the beginning of the Bureau of the Budget in 1939. Building on the excellent foundation laid by Harold Seidman, we were able to launch a major government-wide management program in early 1970 within weeks after the President was sworn in.

Changing BOB to OMB in 1970 resulted from a recommendation from the Ash Council. I had the responsibility for drafting the plan and defending it before Congress.

In the House, Chet Holifield, Chairman of the Government Operations Committee, rightly perceived the politicizing that was likely to occur with the reorganization plan. In the Senate, Senator Birch Bayh Counseled me to support a bill he had drafted which would have provided for a separate office of management within the Executive Office of the President, a very wise suggestion which I then rejected.

When we won a hard fought battle to secure the agreement of Congress to establish OMB, we were hopeful that this change would provide increased emphasis to strengthen government management. This has not occurred.

We were quite surprised when an early instruction from the new OMB leadership was to reduce the management programs we had initiated, particularly those in the intergovernmental area. We later faced opposition from an informal alliance between some of the political PADs within the new OMB and White House staff that quietly undermined some of our work. It was not until Watergate, however, and the departure of Cap Weinberger and Frank Carlucci from OMB, that the real weakening of the OMB management strength became significant.

It was then decided to move a number of key slots from the management part of OMB to the budget part of OMB where these slots could be used for hiring young management associates to work with budget examiners. This had been tried many years earlier, and failed miserably. It seemed clear that it would fail again.

As a result of this management associate decision, I resigned from OMB to become deputy administrator of GSA. The extremely able Deputy Assistant Director for Management, Alan Dean, moved to HEW. Most of the non-organization elements of the OMB management responsibilities were transferred with me to GSA where they remained until I left GSA about 3 years later.

Proximity of the management function to the budget responsibilities of OMB has been listed by some as necessary leverage for management leadership to be exercized. We found the opposite to be true. Although budget leverage could at times be helpful with respect to short term gains, by and large it was resented by the departments and agencies who complied with budget generated management improvement only because they felt they had no real choice, and the longer term effect was negative. Because changes were imposed upon them, they never felt a sense of ownership, and once the pressure was removed, the gains tended to be lost. In fact, it was only when I established our independence from the budget process that we were able to work effectively with the Department of Defense on management initiatives.

It is interesting to note that it was not until financial management improvement was moved from OMB to GSA that we could do research on the amount of overhead costs embedded in our federal grant programs. It was also only after that transfer that we were able to launch a meaningful cash management program under the leadership of John Lordan.

Deeply concerned about the future of management initiatives which were later shifted back to OMB, I recommended to the Carter transition team that the management function be removed from OMB and a separate office of management be established within the office of the President. This was not accepted.

To provide some indications of the potential of a revitalized Office of Management, I will list some of the responsibilities the Office of Management had on the eve of changing BOB into OMB:

1.Reorganization. Throughout its history the Bureau of the Budget provided strong effective counsel to the President and departments and agencies concerning major reorganization issues. Harold Seidman developed a bi-partisan consultative approach to Congress through which executive-legislative branch agreements were reached informally in most instances before the President forwarded a proposal to Congress. Mutual confidence and respect developed through this practice, and provided an example of how the legislative and executive branches can, and should, work together in advancing the common good. Every reorganization plan submitted by President Nixon prior to Watergate was accepted by Congress, including the establishment of the Environmental Protection Agency, because of this close collaboration. Under Mr. Dean's leadership we began the largest reorganization effort in the history of the United States, an effort torpedoed by Watergate.

2. Financial Management. BOB was an active member of the Joint Financial Management Improvement Program. At that time we gave particular emphasis to better auditing. Another major thrust dealt with the strengthening of financial management of the federal grant system, with particular attention given to the adequacy of internal controls. Priority was given to those measures designed to avoid diversion or misuse of funds. BOB also reinforced the GAO effort to encourage better accounting and stronger auditing at all three levels of government.

3. Productivity. A government-wide productivity enhancement program was introduced. The Comptroller General at that time concluded that the government productivity measurement system then in place was roughly equal in quality to that in the private sector. Our greatest problem was the understandable desire of the budget examiners to reduce agencies' budget by the amount of the productivity increases. This, of course, seriously reduced the incentive for improved productivity. For a time we were able to retain for the agencies a portion of the amount saved though productivity. In time, however, the budget pressures eliminated this incentive.

4. Intergovernmental. A major program that was coordinated by the Office of Executive Management was a massive grant decentralization and simplification program which was called "New Federalism". Except for revenue sharing, OEM had the leadership role for a multipronged drive against centralization and red tape in the federal grant area.

Within 90 days of inauguration, a set of sweeping presidential initiatives had been announced, a cabinet meeting had been devoted to these initiatives, executive orders had been issued, and an implementing mechanism had been established throughout the domestic departments and agencies of government. We sought, and received, bi-partisan support in both the House and the Senate. State and local organizations representing governors, mayors, city managers, county executives and state legislatures, gave the program tremendous support.

Extensive flow charts and other data on roughly 400 federal programs were quickly developed which demonstrated the excessive cost in terms of dollars and delays caused by overcentralization of many of our domestic programs. Dramatic changes were made whereby many billions of dollars of grant approvals were decentralized to federal field offices resulting in a major reduction in processing time and cost. More important, this streamlining removed many impediments to state and local governments striving to strengthen their own capacity to govern. The block grant concept was developed, and state and local governments were given a greater share in the running of domestic programs. Because the federal domestic programs were funded through so many different federal organizations, we placed great emphasis on establishing coordinating machinery in the field which would make it much easier for local communities and neighborhood organizations to take advantage of the various federal programs. Regional boundaries were standardized for most of the domestic programs, particularly as they affected urban communities, and federal regional councils were established to help in coordinating numerous federal efforts and to help the state and local governments interact with the federal agencies.

5. Interaction of Managers. Considerable efforts were placed on providing administrative sub-groups in federal departments with exchanges of information and a greater sense of pride in their fields of work. Major management conferences were held each year

in which administrative professional were given a first hand opportunity to discuss the new management initiatives. A Presidential management award system was established. Regional Council chairs, FEB chairs and career assistant secretaries for administration were brought together periodically in the cabinet room of the White House to meet with the President. The Executive Officers group, now called PCMI, was very active in helping the Bureau of the Budget give momentum to Presidential initiatives.

6.Undersecretaries An Undersecretaries Group was established and co-chaired by the deputy director of the Bureau of the Budget and one of the assistants to the President, originally Mr. Moynihan. This group was established for the purpose of building a bridge between the administrative and program management responsibilities of departments and agencies. Its focus was on how to most effectively provide the management underpinning for new and modified programs. In the middle 1970's, this group became bogged down in administrative trivia and was terminated. The Executive Officers Group, however, remained very strong through this period.

7. Procurement. We believed that the procurement system needed a major overhaul. and recommended that a procurement commission be established by the President and Congress to make an in depth review of our aquisition systems in the federal government. As a result, a hard working statutory commission involving both the executive and legislative branches was set up and a series of major

changes in our procurement system resulted. One area in which we failed was that of persuading the Procurement Commission to address in any major way the complex area of detailed procedures that had accumulated like barnicals over the years. We had in mind a streamlining effort similar to the grant simplification program that was then under way. This need has still not been addressed, and the taxpayers are paying the cost of an overly complex federal procurement system.

8. Department Management. Annually I met with most Cabinet members individually to discuss both the department management weakness we had found and the progress being made to correct problems. On several occasions, these dealt with major problems of top departmental leadership.

As I indicated above, the transition from the Bureau of the Budget to OMB not only failed to give new impetus to management in the federal government, but I believe its location has contributed significantly to a substantial lessening of that effort. More and more observers have concluded that it has irretrievably lost its effectiveness as a government-wide leader in management. Several years ago a panel of the National Academy of Public Administration made a study of the overcentralized management systems in the federal government and issued a report entitled "Revitalizing Federal Management: managers and their overburdened systems." In that report the panel observed that:

> "...the budget and related national economic issues have usually proved to be all time consuming. In recent years it has become so intense that it has almost totally preoccupied critical OMB leadership, draining away time, interest, and staff from the managerial initiatives. Further, the annual focus on the budget and the lack of concerns with management matters clearly has a chilling effect on many management initiatives...it finds OMB no longer has the talent base nor the recognized capacity for leadership to sustain such major efforts. Nor does it appear likely that in the forseeable future, the budget preoccupation will decline and therefore proposals and agreements for building up and revitalizing OMB's 'management side' seem less hopeful and less realistic. Meanwhile the need for strong management reform leadership became pressing."

The panel went on to recommend the establishment of an Office of Federal Management which would include such functions as the drafting of non-budget related executive orders, management circulars and other presidential management guidance or directives. It would coordinate responses to GAO audits involving more than one department. It would provide leadership for financial management, procurement, paper work reduction, productivity, and other fields of management concern. The Office would represent the President, in cooperation with the White House Congressional Office, on government organization and management matters and would coordinate preparation of Administration management related legislation. It would also review other major legislation with respect to managerial impact.

This office would continue to advance improvements in administrative management, but would be expected to reverse the recent OMB preoccupation with detailed and centralized administrative systems and procedures, giving priority instead to effective program management and the administrative support these programs require.

Therefore, its clientele would include program assistant secretaries and undersecretaries and cabinet members, as well as assistant secretaries for administration and chief fiscal officers and inspector generals. This new office would be expected to restore the close cooperation the Bureau of the Budget once had with Congress, and also with organizations outside the government whose capacity to manage their affairs are impacted by a variety of different government department and agencies. This office should restore the earlier capacity of the federal government in testing new programs from the vantage point of the consumer of government services, that is, the various elements of the American public. Above all, this office should shift emphasis from the existing concentration on centralized administrative systems to that of helping with management capacity building of department and agencies. As a part of this shift in emphasis, the new office should help the departmental leadership rediscover the federal field offices and the importance of providing employee development opportunities for those located outside Washington. I would hope it could give far stronger support to OPM in human resource development than has OMB.

Speaking of OPM, I would note that the Office of Personnel Management is moving forward with considerable vigor under the capable leadership of Connie Newman. I do not think her efforts would be nearly so successful, however, if leadership for personnel management were placed in OMB where it would be only one element in a large organization which was swamped with difficult budget and economic policy issues. Fortunately, no one is suggesting such a move, but the current OPM location further demonstrates that one does not have to be in a budget agency to be effective.

Mr Chairman, in conclusion I would simply say as the one responsible for drafting and defending the earlier reorganization plan establishing OMB, I believe we made a mistake. It has not worked well. At the same time, I am more optimistic than most people with respect to our ability to provide the kind of managerial leadership that had been contemplated for OMB. Therefore, I would urge this Committee in cooperation with the Governmental Affairs Committee and the White House to give renewed attention to revitalizing federal management, including serious consideration to establishing an Office of Management before our federal management efforts erode further. No amount of increased external oversight can compensate for poor departmental management.

NAPA
National Academy of Public Administration

STRENGTHENING PRESIDENTIAL LEADERSHIP BY ESTABLISHING AN OFFICE OF FEDERAL MANAGEMENT

Prepared for the 1988-89
Presidential Transition

A Statement of the
Standing Panel on
Executive Organization
And Management

Alan L. Dean
Chairman

Officers of the National Academy

Joseph L. Fisher, Chairman of the Board
Astrid E. Merget, Vice Chairman
Ray Kline, President
Sheldon S. Cohen, Secretary
Anita F. Alpern, Treasurer

The National Academy of Public Administration

The National Academy is chartered by Congress to advance the effectiveness of government at all levels through sound management and counsel on the practical implications of public policy. In its extensive work program, the Academy conducts studies and performs services for state and local governments, and the three branches of the federal government.

Fellows of the Academy are elected by their peers and consist of practitioners and scholars of public administration, members of Congress, cabinet officers, state government executives, city and county managers and mayors, and business and independent sector leaders with significant public service experience.

The products of Academy studies represent the views of the participants and not necessarily the Academy as an institution.

STRENGTHENING PRESIDENTIAL LEADERSHIP
BY ESTABLISHING AN
OFFICE OF FEDERAL MANAGEMENT

A Statement of the

STANDING PANEL ON EXECUTIVE ORGANIZATION

AND MANAGEMENT

NATIONAL ACADEMY OF PUBLIC ADMINISTRATION

Prepared for the

Academy Study of the Presidency

and the

1988-89 Presidential Transition

December 1988

PREFACE

The 41st President of the United States knows the critical issues, such as reducing the budget deficit, which he faces. There is, however, another set of issues that will be of vital importance to his administration. They will affect the President throughout his tenure and practically every decision he makes. Broadly stated, these are the issues of how to provide effective government and sound management at reasonable cost to the taxpayer.

The Academy has conducted a number of studies concerned with strengthening the management and improving the performance of the Executive Branch, with considerable attention being given to the Office of Management and Budget — the President's principal staff office for providing management leadership. The fruits of these studies boil down to a few basic concepts about Executive Branch management.

1. The President must provide the agenda for government-wide management improvement initiatives.
2. The performance of the Executive Branch depends most directly on the quality of management in the departments and agencies.
3. The President needs a strong Executive Office capacity to develop and drive his management agenda.

On this third point, the unanimous view today is that the Executive Office capacity is not as strong as it should be in matters of management reform. Opinions vary on how to strengthen it — all the way from an OMB deputy director for management, with a beefed-up management and support staff, to a new Office of Federal Management reporting to the President.

This statement of the Academy's Standing Panel on Executive Organization and Management, prepared by Charles F. Bingman, advocates the Office of Federal Management option. Initially recommended by an Academy panel in 1983 report, Revitalizing Federal Management, this concept of a separate management office reporting to the President has been refined and fleshed out over the past five years in deliberations of the Standing Panel and by the Senate Committee on Governmental Affairs during the 99th Congress.

However President Bush chooses to develop his administration's management agenda, we believe he will need strong leadership and staff support to carry it out. OMB's limited staff size and its daunting task of dealing with the budget deficit may warrant his choosing another vehicle for the management task. This statement advocates just such an approach and provides him the blueprint for doing so.

Ray Kline

Ray Kline
President

I.

WHY AN OFFICE OF FEDERAL MANAGEMENT IS URGENTLY NEEDED

For a number of years, National Academy of Public Administration (NAPA) panels and others have become increasingly concerned that the federal government is failing to keep the management of its programs up to adequate standards of performance effectiveness and is no longer providing fully effective service to the public.

As used in this statement, "federal management" means the whole vast array of federal organizations, personnel, facilities, systems, regulations, and processes which are used to direct the federal government's programs and supporting activities. As an operating entity, the federal government dwarfs even the largest of private sector companies. There are 4.6 million federal employees, including the uniformed military services. Federal land and structures are valued at $104 billion and, by any conservative estimate, are worth far more. In addition to its $42 billion in buildings to house its people, the government leases 83 million square feet of additional office space. It spends more than $180 billion per year on goods and services, manages approximately 900-1000 grant-in-aid programs, and administers almost 19 million procurement contracts.

Maintaining this immense public establishment is, in itself, a management responsibility of staggering dimensions. But more importantly, these resources are crucial to the management of federal programs -- everything from national defense and foreign policy, to national programs for health care, social security, housing, environmental protection, highways, and space exploration. Federal programs impact almost every American citizen, state and local government, and private corporation. The question of how well the federal government manages its affairs has become a matter of crucial national concern.

In its 1983 report entitled Revitalizing Federal Management, a NAPA panel stated:

> The Federal government has been a growth industry over the last thirty years, and federal managers have had to accommodate to an unprecedented increase in the range and complexity of their responsibilities. Dozens of new programs have been created and new organizations established to run them, including five new Cabinet departments. More new regulatory programs have been initiated in the last thirty years than in any other comparable period in national history. The federal government now manages — either directly or

> indirectly through grants and contracts — some of the most important and complex enterprises in the world. This is a world where management is vitally important and the public expects and demands good performance. Despite often valiant efforts to solve specific management problems, the last decade has been a period of declining managerial effectiveness in the federal government. Efforts at improvement have been increasingly sporadic, poorly planned, and inadequately backed and staffed. 1/

Other observers both in and out of government voice this same concern. The Comptroller General of the United States, Charles A. Bowsher, has said that the General Accounting Office (GAO) had "looked closely at the history of centrally directed management improvement programs over the last 10 years. The results were not encouraging. We found a record of periodic initiatives, few of which have made any lasting impact." 2/

The report of the President's Private Sector Survey on Cost Control (PPSS), also known as the Grace Commission, provided President Reagan a similar view:

> It is admittedly a staggering task to manage an organization whose size dwarfs even the largest private sector corporations. Still, the federal government is also an organization with human and financial resources of gigantic dimensions, and it would appear that one Administration after another has simply not been as effective as it should have been in productively employing these resources. The thousands of recommendations of the PPSS attest to the work that can be done — and needs to be done right now — to bring the management of the federal government under control. 3/

The Grace Commission further stated that "these deficiencies are not the result of lack of competence or enthusiasm on the part of federal employees. Rather, responsibility rests squarely on the Executive Branch and the Congress which, in the final analysis, are the joint architects of the federal government's management systems, policies and practices." 4/

The American public has also become increasingly concerned, and in recent years, has converted this concern into action. In a recent book, it was pointed out that, since 1977, no fewer than 25 states have enacted new statewide tax or spending limitations, giving permanence by state constitutional amendments and other formal measures limiting future spending growth. These measures have "made it impossible for elected officials to return to business as usual, even if they had been so inclined." 5/

While these measures dealt largely with tax and major public program policy, it is clear that they also reflected public concern over the size, cost, and inefficiency of public institutions.

The Reagan Administration obviously shared this concern since it launched Reform '88, one of the most broad-ranging programs of management reform and improvement in recent history. In its 1985 report accompanying the President's Budget, Management of the United States Government, OMB stated:

> After decades of sporadic effort, the problem of management systems — a problem that transcended changing Administrations — still required urgent attention. There was still no broad program in place to ensure a continued, organized emphasis on management improvement.6/

These strong messages cannot and should not be ignored. The government's "deficit" in its own management is getting worse instead of better, and simply cannot be eliminated by its present array of management institutions and systems. The time has come to reexamine the structure and resources available for use in fighting this managerial deficit.

II.

THE ROLES OF THE CENTRAL MANAGEMENT AGENCIES

Responsibility for effective management lies primarily with the departments and agencies, and in the authorities of agency heads. A very large proportion of both problems and cures relate to how well these agencies perform. But it is a fact of life — and a part of the problem — that much of the structure and systems of federal management are highly centralized in nature, that is, Congress and the President have created powerful central agencies to exert government-wide control over management policy, systems, and practices. These central agencies are the Office of Management and Budget (OMB), the Office of Personnel Management (OPM), and the General Services Administration (GSA). They have been vested with power to deploy and enforce government-wide systems and regulations which, in large part, dictate how — and how well — the government manages its programs and meets public needs. This centralization traditionally has been viewed as necessary to provide the President with the resources to exert his leadership as the chief executive of the Executive Branch, and to focus accountability to Congress on management matters. But it is increasingly clear that neither of these crucial objectives is being adequately achieved. To again quote Comptroller General Bowsher:

> This record (of failure of the traditional central agency focus) is the result of the inherent limits on what can be done through the efforts of central agencies. Their drawbacks include:
>
> First, the centrally directed approach causes unavoidable confusion between issues of program policy and program execution. Successful implementation depends on effective management support.
>
> Second, the centrally directed approach allows those responsible for day-to-day management of government programs and agencies to escape accountability for the results of their actions.
>
> Third, the centrally directed approach diverts energy and attention from the operating agencies, where the problems really are, and where effective solutions must be found and implemented. 7/

While noting the importance of OPM and GSA, the National Academy's 1983 report concentrated on OMB, recognizing that since before World War II, OMB (and its predecessor, the Bureau of the Budget) has been the primary and most influential agency in the arena of government management. The report states: "The NAPA panel has been forced to conclude that the federal government's pressing needs for broad-based and sustained management reform can best be accomplished by the creation of a new Office of Federal Management (OFM) in the Executive Office of the President, which should become the framework for providing a more powerful and responsive leadership for management reform and improvement for the entire federal government." 8/

The Grace Commission report to the President arrived at this same conclusion, stating:

> PPSS, in analyzing federal government operations and identifying opportunities to cut costs, concluded that a major obstacle to improving the efficiency and effectiveness of the government is the federal structure itself. PPSS identified the need for a mechanism at the top level of government to provide much greater emphasis on management improvement. Accordingly, PPSS recommended the establishment of an Office of Federal Management (OFM) in the Executive Office of the President, responsible for policies and programs throughout the government to improve financial management information systems, to coordinate reporting policies and procedures, to assure effective management of human resources, and for planning and budgeting. 9/

COMPARISON OF PROPOSALS FOR A NEW CENTRAL MANAGEMENT AUTHORITY

The views of the Comptroller General, National Academy of Public Administration panels, the Grace Commission, and scholars in the field, as well as the past actions of Congress, clearly portray the ambiguity which is felt about the role of these central agencies, especially OMB. All recognize that these central agencies are a necessary and important element of government and that there are key government-wide management responsibilities which they must exercise. These responsibilities include development and issuance of management policy; operation or oversight of certain common management systems; promulgating standards for the performance of management functions; and oversight on behalf of the President with respect to agency compliance and performance effectiveness.

While the NAPA and Grace Commission proposals for an Office of Federal Management are very much in agreement in most ways, they differ substantially as to the nature of the role which an OFM should play. In the Grace Commission proposal, the OFM would add GSA and OPM policy functions to the current OMB to produce a single "conglomerate" office of great scope and power. Congress would be reluctant to vest such power in a single presidential unit. More feasible would be the model proposed by the NAPA panel which would break out the management-oriented roles of OMB to form the new OFM, leaving GSA and OPM as independent entities; the OMB budget functions would go to a residual, highly important Office of the Budget.

The Grace Commission took the position that the President is the chief executive officer of government almost in the corporate sense, and it saw the OFM as exercising even greater central power and authority on behalf of the President. It presumed that OPM and GSA would continue as separate, semi-independent entities, but only for operations in their respective areas. All policy functions with which these institutions now deal would be brought into OFM's front office staff.

The NAPA proposal would continue to recognize the independence of OPM and GSA as well as the central budget office. The panel resisted the urge to propose a single all-powerful institution, even recognizing that its approach to the creation of the OFM would mean that there would be four central agencies rather than three, and that the necessity for coordination of these four institutions would be even greater. Thus, one "power" argument centers around the wisdom of a single, all-powerful presidential agency, or a pattern of four which must work together, and balance each other off.

THE LINK BETWEEN MANAGEMENT AND BUDGET

At the heart of this argument is the link between management and budget. In the history of the old Bureau of the Budget, and indeed in the creation of the current OMB, it was argued that this combination would have great value; that the processes of budget examination would identify many of the problems of government on which OMB's management experts should work. In turn, management reform and improvement ventures would derive their real power and influence from being linked with the budget. This "power by association" appeared to be a major factor in the Grace Commission approach.

The NAPA panel members, many of whom supported the creation of the OMB, rejected this perception. In its report, the panel stated that "the disabling systemic weakness is that the budget and related national economic issues have usually proved to be all-consuming. In recent years, it has become so intense that it has almost totally preoccupied critical OMB leadership, draining away time, interest, and staff and having a chilling effect on many management initiatives. Therefore, even when an Administration such as that of President Reagan seeks to take the initiative for management reform across a broad front, it finds OMB no longer has the talent base nor the recognized capability for leadership to sustain such efforts." 10/

It does not appear likely that, in the foreseeable future, the budget responsibility will decline. Indeed, preoccupation with the budget deficit is almost assured. Therefore, proposals and arguments for building up and revitalizing OMB's management side seem less hopeful and less realistic now.

But the fundamental argument here is also the one raised by Comptroller General Bowsher. The current concentration of strength in the central agencies has not worked. It has not produced effective management, and it has not kept the government up to date with the best contemporary management concepts and practices. It has not even prevented waste and abuse, or prevented the deterioration of current management capability. The 2,478 reform recommendations of the Grace Commission, and the breadth and scope of Reagan management reform programs are telling witnesses to the degree to which the federal government has failed to keep on top of its problems. Further centralist concentration as proposed by the Grace Commission does not seem to be the answer, nor is it clear whether Congress—always ambivalent toward Executive Office power—would be willing to permit the creation of such a "super OMB."

RECOMMENDATION

The President should recommend and Congress should enact legislation establishing an independent Office of Federal Management and retaining a separate Office of the Budget, General Services Administration, and Office of Personnel Management.

The NAPA Standing Panel continues to believe that this is the most effective organization which the government could create to pursue presidential management imperatives. OFM and its relationships to these other organizations are described in more detail in Section III of this report. It should be noted, however, that both Comptroller General Bowsher and the NAPA study report propose a totally different view of the role of the central agencies — one in which the "center of gravity" of government management reform is at the agency level, and one in which the central agencies function in a way which aids and facilitates the individual and group efforts contributing to common government-wide solutions. This is decentralization rather than centralization, and it is a realistic recognition that most management issues, good and bad, really must be attacked at agency levels. As stated in the NAPA report:

> The most powerful answer which the NAPA panel sees to the solution of pervasive government overburden and obsolescence is to create a new environment which seeks to shift the center of concentration and effort for management reform into the hands of a broad range of senior and mid-level managers and supervisors, and to use the authority of the President and the leverage of the central agencies to motivate this executive/manager level and support its initiatives. 11/

Thus, the critical issue is not whether the central agencies are powerful. They are, and will remain so, because they must have the capacity to serve the President effectively. If the old forms are not fulfilling the necessary management leadership role, then it is time to reexamine the organizations which exercise that power.

The Office of Federal Budget, which would remain after the removal of the management functions, obviously would be a powerful and valued organization. It would continue to report to the President, and its director could remain a member of the Cabinet. Its principal role would be as the President's agent and staff capability in the highly complex and sensitive arenas of budgeting, resource allocation, and economic analysis. Budget examiners would continue their assessment of federal program performance as a vital element in budget formulation and as a source of advice to the President.

The budget itself would continue to be an important vehicle for management matters, because management reforms require resources or changes in policies which must be reflected in the budget and justified as part of the overall budget review process. Each year, the present OMB conducts spring previews for its director which are broad budget planning frameworks. Then, in the fall, the budget review provides the director with a vehicle for many final budget decisions. In recent years, OMB has taken various approaches to linking management reviews to the budget process. Last year, OMB assigned the budget review function for GSA and OPM to the Associate Director for Management. The management reviews could be continued, and they would provide an excellent way to link the OFM and the Office of Federal Budget together.

The OPM and GSA would continue as independent entities, much as they are now. There are clear advantages in having these organizations remain in charge of their current responsibilities as opposed to complicating the role of the OFM with these burdens. OPM and GSA would continue developing management standards, policies, performance evaluations and agency oversight for their areas of concern, and each would continue to be responsive to Congress for execution of the laws under their jurisdiction.

But the OFM should serve as the primary agent of the President in developing and directing comprehensive management policies, and it would require that OFM take a leadership role with respect to OPM and GSA, as well as all of the other departments and agencies of the government on management matters requiring central coordination.

III.

THE OFFICE OF FEDERAL MANAGEMENT: ROLES AND OBJECTIVES

ORGANIZATIONAL ROLES

The Office of Federal Management should be an independent office in the Executive Office of the President, reporting directly to the President. Its director should have cabinet rank. For those who argue that the budget is the real power base for management concerns, it should be pointed out that, even in the current OMB, it is recognized that the real source of its influence is not the budget per se, but direct and continuing access to the President and real relevance to the President's needs. The importance of budget issues and the need for presidential response and decision making is the vehicle for such access and relevance. But the range and importance of management issues are such that they would also assure that same access and relevance. Currently, this right of access is more theoretical than real if the OMB director is unwilling to invest part of his limited access time on management matters. This relationship with the President would be further assured if the OFM were given responsibility for preparation of executive orders, proclamations and other presidential directives; and for development, review, and coordination of administration legislative initiatives in the management arena, as OMB ought to be doing now.

OFM's strength would lie in its role as the management agent of the President, and its ability to act on behalf of the President across government. OFM's authority must extend to all government functions, even where principal responsibility rests with other agencies. This is true of OMB now, and it has led to problems of conflict and overlap with individual departments and agencies. These conflicts are bureaucratically manageable, however, and such conflicts are preferable to the capability vacuum which exists now.

OFM's role would, of necessity, have to be authoritative. Presidents must give orders, and therefore, their agents must be able to promulgate such orders and enforce them. But the entire approach of the OFM, as discussed in this statement, must be to change away from that of OMB's top-down approach if it is to serve the President effectively. OFM must be the catalyst which galvanizes effective management throughout government. More specifically:

1. It must develop and gain agreement in the Executive Branch and Congress on an overall strategy for its management roles and objectives, and on an agenda for specific management programs and projects.

2. Its role should be truly "executive" — not just to study or examine, but to create action, primarily through others, so that the whole federal establishment is motivated to maintain a high order of management effectiveness. OFM should evaluate the management roles and effectiveness of executive branch agencies so that it can give advice and recommendations to the President on corrections and improvements, but the spirit of the oversight should be positive and constructive rather than negative and punitive.

3. OFM's role should be to facilitate; to instigate, promote, and assist; and not primarily to regulate, control, or audit. The federal government has more than enough audit/regulatory mechanisms and overseers. What it suffers from is not the lack of ability to evaluate itself; it suffers from an inability to take action and to implement change. It has all too few agents that can create sustained and coherent action, and therefore the OFM role in designing and directing action is too precious to be allowed to dissipate into that of another regulator or "watchdog." A serious failure of the central agencies in recent years has been that, in their preoccupation with their regulations, they have been a force for rigidity, entrenchment, and stultification, instead of loosening up the system, dislodging entrenched interests, promoting innovation, and creating the capacity and the will to experiment.

4. Finally, the establishment of the OFM would give the federal establishment something which we now more clearly see that it lacks: a full-time, committed, influential organization which is the government's advocate and leader for better management 365 days a year. OFM's director would have the attention of the President, the Cabinet, and Congress, and it would not be diverted by the budget or anything else. In addition to its appointed political leadership, OFM should have a high-quality staff of both career civil servants and others from outside of government, all of whom should be broadly experienced and knowledgeable about government and able to sustain management reform for the long term. Under a director and a deputy director chosen by the President, OFM should become the major leadership force for restructuring, redesign, and rationalization of the institutional architecture of the federal establishment.

SPECIFIC OFM MANAGEMENT ACTIVITIES

The potential array of relevant management activities is very broad — far greater than is exercised effectively by the current OMB. It includes the following:

1. Government organization matters
2. Staffing and workforce management
3. Procurement policy and systems
4. Financial management systems and controls
5. Human resources management
6. Management information systems
7. Productivity enhancement
8. Cash management systems and oversight
9. Credit management systems and oversight
10. Government capital investment and management
11. Travel and transportation services
12. Intergovernmental relations
13. Paperwork management and control
14. Regulatory review and reform
15. Real and personal property management
16. Management evaluation systems
17. Planning and program management systems
18. Auditing, investigation and inspection
19. Control of fraud, waste, and abuse
20. Grants management systems and techniques
21. Evaluation of agency management performance
22. Reports, statistics and publications policy
23. Privatization and relations with the private sector
24. Management research and demonstration programs
25. Design and development of new management systems
26. Freedom of Information Act compliance
27. Privacy Act compliance
28. Printing and reproduction policy and operations
29. Start-up assistance for new agencies or programs
30. Government corporations and public enterprises

31. Regional and field office organizations

While this listing clearly deals with administrative management systems and procedures, it should be made clear that the OFM role includes the management of federal programs and not just staff functions. In fact, the primary concern in government should be to improve program delivery, using management systems and processes to support that purpose, and not as ends in themselves. OFM would evaluate program design, program planning systems, program management techniques, productivity, quality control, and program cost effectiveness. It might be called on to do specific studies and reviews of specific program areas such as loan-making or research and development. OFM should be the government's expert on program design and operations and should be able to provide start-up (or phase-out) assistance for agencies or programs. This does not mean that OFM must be staffed with experts on every government program. Rather, it requires generalist talent, capable of evaluating any program, with expertise in grants assistance, procurement and contracting, loan and loan guarantee programs, and regulations, as well as the government's own direct in-house operations.

OFM MANAGEMENT TOOLS

For those who may be concerned that the OFM would be powerless without the budget to lean on, a look at the tools which could be available to the OFM will dispel that concern.

Statutory Authorities

In establishing this office by statute, Congress would likely transfer to it OMB's responsibilities under the following laws:

1. The Paperwork Reduction Act
2. The Prompt Payment Act
3. The Debt Collection Act
4. The Federal Managers Financial Integrity Act
5. The Single Audit Act
6. The Government Corporation Control Act
7. The Freedom of Information Act

8. The Privacy Act
9. The Office of Federal Procurement Policy Act
10. The Federal Reports Act
11. 31 U.S.C. 1111 on improving economy and efficiency and related sections in title 31.

Presidential and Administrative Authorities

In addition to the statutory authorities listed above, the President has issued many executive orders or other directives which deal with management activities within the Executive Branch. OFM should take over the administration of these executive orders and directives, as well as the preparation and coordination of future executive orders and proclamations for the President. The established system of OMB circulars would become OFM circulars, except for those dealing with budget matters.

As previously noted, OMB has conducted a management review in the spring in conjunction with the budget preview for the OMB Director. This process should be continued with OFM making the management presentation. This process would be a valuable link between OFM and the "price-out" of management activities in the budget.

OFM should also assume responsibility for the Office of Federal Procurement Policy and its procurement policy role, as well as the Office of Information and Regulatory Affairs with its regulatory review and information resources management roles.

In addition, OFM should assume primary responsibility for coordination and utilization of the President's Council on Integrity and Efficiency (PCIE), and the President's Council on Management Improvement (PCMI). These councils have been given great vitality and scope by the Reagan Administration as a more organized means for coordinating the relationship of the central agencies with each other, and between the central agencies and the departments and other agencies of the Executive Branch. As long as they are available, OFM should be the principal line with them.

One further concept deserves serious consideration. The Federal budget has always served as a general management tool which can be used to explain and justify management needs, plans, priorities, and resource requirements. But the enormous pressures in recent years on the budget have resulted in substantial deterioration of its use as a management planning tool. Therefore, it would be highly desirable to examine the development and use of a "management plan" as an alternative means by which each agency could define its own strategy for achieving management effectiveness and productivity. These management plans would also become the basis for oversight by OFM and Congress, and when approved, could serve as a means for evaluation of agency performance. The use of management plans would also give greater visibility and coherence to management issues and problems and permit management needs to be justified and defended on their merits without being overpowered by budget pressures.

MANAGEMENT RESEARCH

There is no arena of management which OMB has so undervalued as that of management research and the conduct of test and demonstration programs. Despite its huge size and vast resources, the federal government makes pitifully poor efforts toward the conduct of management research, the identification of new management concepts or techniques, or the conduct of management demonstrations or tests aimed at adapting best contemporary management systems and practices into modern public administration. It is not necessary for the federal government itself to be heavily engaged in management research, since much is being done elsewhere which can be used. But the creation of OFM could be the basis for a whole new and more vigorous program of management research and innovation aimed at maintaining the government's vitality and effectiveness for the future.

ENDNOTES

1. National Academy of Public Administration, Revitalizing Federal Management: Managers and Their Overburdened Systems (Washington: NAPA, November 1983), p. 1.

2. Charles A. Bowsher, "Building Effective Management," The Bureaucrat, Winter 1984-1985, p. 26.

3. J. Peter Grace, War on Waste (New York: MacMillan Publishing Co., 1984), p. 19.

4. Ibid., p. 20.

5. The Reagan Experiment: An Examination of Social and Economic Policies under the Reagan Administration, John L. Palmer and Isabel V. Sawhill, eds. (Washington: The Urban Institute, 1982), p. 14.

6. U. S. Office of Management and Budget, Management of the United States Government, FY 1986 (Washington: GPO, 1985), p. 9.

7. Bowsher, p. 26.

8. National Academy of Public Administration, p. 12.

9. Grace, p. 73.

10. National Academy of Public Administration, p. 12.

11. Ibid., p. 8.

STANDING PANEL ON EXECUTIVE ORGANIZATION AND MANAGEMENT

Mr. Alan L. Dean, Chairman
Mr. Mark Abramson#
Mr. Stephen L. Babcock#
Mr. Marver H. Bernstein
Mr. Charles F. Bingman, Vice Chairman
Mr. Ralph C. Bledsoe
Mr. James L. Blum
Mr. Walter D. Broadnax
Ms. June Gibbs Brown
Dr. John M. Clarke
Mr. James E. Colvard (ex-officio)
Mr. David O. Cooke, Exec. Com.
Mr. Phillip J. Cooper#
Mr. Charles L. Dempsey, Exec. Com.
Mr. Gene L. Dodaro#
Mr. Robert Fairman
Mr. Joseph L. Fisher (ex-officio)
Dr. Lyle C. Fitch
Mr. Andrew B. Fogarty
Mr. Richard L. Fogel
Mr. Robert Gilmour#
Mr. Bernard L. Gladieux
Mr. William T. Golden
Ms. Sandra J. Hale
Mr. Bertrand M. Harding
Mr. Matthew Holden
Dr. Stephen Horn
Mrs. Constance J. Horner
Ms. Mary Evelyn Huey
Mr. Dwight A. Ink
Mr. Herbert N. Jasper
Mr. Thomas S. McFee
Mr. Howard M. Messner
Mr. Michael Mitchell#
Mr. Ronald C. Moe
Mr. Paul H. O'Neill
Mr. Max D. Paglin
Mr. William W. Parsons
Mr. Bradley H. Patterson
Mr. James P. Pfiffner#
Mr. Ed Preston#
Mr. Gerald Riso
Mr. Harold Seidman
Mr. Roger Sperry#
Mr. Sydney Stein, Jr.
Mr. John G. Stewart
Mr. Donald C. Stone
Mr. Earl Walter#
Mr. Don I. Wortman
Mr. Alfred M. Zuck
Mr. Eugene M. Zuckert

Non-Academy Fellow

SELECTED ACADEMY PUBLICATIONS

The Presidential Appointee's Handbook (1988)

Congressional Oversight of Regulatory Agencies: The Need to Strike a Balance and Focus on Performance (1988)

The Executive Presidency: Federal Management for the 1990's (1988)

Prospects for the Item Veto at the Federal Level: Lessons from the States (1988)

Welfare Reform Dialogue: Implementation and Operational Feasibility Issues (1988)

Strengthening the U.S.-Soviet Communications Process to Reduce the Risk of Misunderstandings and Conflicts (1987)

Third-Party Government and the Public Manager: The Changing Forms of Government Action (1987)

Presidential Management of Rulemaking in Regulatory Agencies (1987)

The Quiet Crisis of the Civil Service: The Federal Personnel System at the Crossroads (1987)

Professional Career Entry into the Federal Service (1987)

Equal Opportunity and Management Practices in NASA Headquarters: An Assessment and Recommendations for Action (1987)

The Next Generation in the Management of Public Works: Getting Some of It Together (1987)

Improving Facilities Management for the U.S. Courts (1987)

Leadership in Jeopardy—The Fraying of the Presidential Appointments System (1985)

Revitalizing Federal Management: managers and their overburdened systems

(PARTIAL REPORT: CHAPTERS 1 and 2 ONLY)

An assessment of how excessive controls constrain Federal managers.

A panel report of the
National Academy of
Public Administration

November, 1983

CHAPTER ONE

Diagnosing The Problem

By any standard, the Federal government is an enormous management undertaking. Last fiscal year, there were Federal outlays of more than $728 billion, or the equivalent of $3,200 for every man, woman, and child in the United States. Receipts flow into government financial institutions at the rate of more than $3 billion each working day. Each year more than $935 billion in disbursements go out, and it costs more than $600 million just to print and distribute the checks. More than 200,000 employees are needed to maintain this enormous financial system, the Federal budget process, and related auditing, accounting, and fiscal control operations. Last year, the Federal government completed 18 million procurement transactions paying out more than $159 billion to several hundred thousand contractors delivering goods or services to Federal, state, and local governments. An estimated 135,000 employees are needed to operate procurement and supply systems. One third of the total land mass of the United States is owned by the Federal government and managed by people in various Federal agencies. Billions of checks go out each year to recipients of Federal programs. Federal agencies are now managing a portfolio of more than $765 billion in loans to individuals, companies, and governments, including foreign countries.

Even the government's internal operations are staggering. There are 2.1 million Federal employees (excluding the Postal Service) whose payrolls, benefits, and retirement fund cost $64 billion a year. These employees need 2.6 billion square feet of building space—more than the combined office space of our 10 largest cities. The government has 17,500 word processing systems, more than 19,000 medium and large computers, and countless employees just to develop and maintain its data processing capability.

The Federal government has been a "growth industry" over the last 30 years, and Federal managers have had to accommodate an unprecedented increase in the range and complexity of their responsibilities. Dozens of new programs have been created, and new organizations established to run them, including five new Cabinet departments. More new regulatory programs have been initiated in the last 30 years than in any comparable period in history. The Federal government now manages—either directly or through grants and contracts—some of the most important and complex enterprises in the world. Their range and variety are astonishing: medical research, space exploration, environmental protection, weapons system development, public lands management, child care, social security, air traffic control, highway and transit construction, medical care, drug enforcement, unemployment compensation, weather forecasting, foreign embassies—to name just a few.

These facts and figures show that the Federal government is not just a world of politics or large policy issues or headline-grabbing events; it is also a world where *management* is vitally important and where several thousand Federal executives and managers actually direct the government's business, and the public expects and demands good performance. This same group of managers is also under constant pressure from Congress and Executive Branch leaders who know that the size and cost of government is a major political issue and who press managers to do more with less and do it better.

"The Federal government is not just a world of politics or large policy issues or headline-grabbing events; it is also a world where management is vitally important. . . ."

In this environment, it might be reasonable to assume that the highest priority is being given to steps which strengthen the role of Federal managers and equip them with management systems which are the best possible tools to help them be effective. In fact, this is not the case.

It is the conclusion of the NAPA Panel that the role of the Federal manager is being seriously undervalued, and that the Federal management systems have become so burdensome and constraining that they reduce rather than enhance management effectiveness.

This report deals with two main interrelated themes:

- How Federal management systems have become overregulated, overburdened, and stultifying.
- Why systems tend to constrain managers and choke off the kind of individual innovation and initiatives which are crucial to real management effectiveness.

This report deals in its various sections with problems of overburden and obsolescence which now plague the budget process, the Federal personnel system, the procurement/acquisition system, and procedures for managing computers, real property, supply and equipment services, printing, and travel. Each of these management systems has its own problems, but all are part of a total framework of management principles and doctrine which heavily influences how the Federal government manages its affairs. The major premise which generated this study was the belief, shared by a broad spectrum of Federal managers, that Federal management systems are now overregulated in the sense that, by accretion, each has acquired an overburden of controls, limitations and constraints, reviews and approvals, data requirements, and other mandates, which, in total, significantly reduce their value and effectiveness. In this process of accretion we have been losing sight of the fact that these systems are not ends in themselves but exist to serve their more important purpose as tools for managing Federal programs.

"The ultimate consequence of neglect is not simply to make the lives of bureaucrats more difficult. Instead, the delivery of Federal programs becomes . . . more costly and less effective."

This report is not the documentation of crisis. None of the major management systems of government is about to collapse. But it is a diagnosis of the consequences of neglect and indifference, both of Federal managers and of the systems which control them.

The systems of government are becoming obsolete or falling into disrepair faster than we currently know how to fix them. The ultimate consequence of such neglect is not simply to make the lives of bureaucrats more difficult. Instead, the delivery of Federal programs becomes slower, less responsive, more costly, and less effective. Waste, mismanagement, and even fraud becomes more evident. Where systems become dysfunctional—where they become difficulties to be overcome rather than aids to help managers manage more effectively—then professionalism of the public service is eroded and some people turn passive and indifferent.

How has this condition of overburden and internal overregulation come about? What needs to be understood before the right kinds of corrective measures can be identified? How should overall systems concepts and processes be changed?

Loss of Managerial Control

The term "manager" as used in this report is intended to refer to those officials who are delegated authority to direct Federal activities, commit the government to actions, obligate and expend public funds, and supervise the workforce. Of necessity it includes Cabinet Secretaries and other agency heads, and it also includes several thousand other political and career people who serve as executives, managers, and staff directors, most of whom function under specific delegations of authority from their own agency heads.

The term "management systems" is a general term which applies to a range of formally defined techniques to be used by managers in carrying out their broader management authority. The sponsors of this report chose for detailed assessment the budget, procurement, personnel, information management, real and personal property, printing and travel systems because of their importance as management tools and the belief that they typify what is good or bad about the quality of Federal management overall.

The main sources of formal authority in government flow from laws and from the delegation of Presidential authority. These authorities normally are given to an agency head, who is held accountable both to the President and Congress for running his/her agency and properly carrying out its business. This vesting of authority is extremely important in a government of separated powers, and indeed every statute, Executive Order, and regulation must clearly state what authority officials are empowered to exercise.

Many such statements are general in character since they rely on the principle that agency heads should be given sufficient latitude to exercise their discretion and judgment in the management of their organizations.

A longstanding counterpoint to the granting of authority is the concern about accountability. Government officials are considered to have a special obligation to account for the manner in which they exercise their public powers and spend public funds, and thus statutes, Executive Orders, and regulations also usually attempt to define how and to whom this accountability must be rendered.

Thus, a careful formal structuring of authority and responsibility through a legally mandated framework of statute and regulation has become one of the fundamental characteristics of government. This principle has been carried through into the further implementation of Federal management systems, but in this context formality and structure come into conflict with the reality of what is needed to achieve excellent and cost-effective management.

"The greater the number of procedural requirements to be met, and the greater number of people who are involved in any action, the less a manager can be held accountable for an action.

The Panel of the National Academy of Public Administration found that, although these systems vary substantially in purpose and mechanics, they shared many common characteristics and general conclusions can be formulated about them. These conclusions are profoundly disturbing. The Panel came to feel that the evolution of the development and use of these systems over many years has resulted in excessive procedures, thus creating a serious impairment in the exercise of general management authority throughout the Federal establishment. In fact, *the Panel believes that the whole focus of the government's institutional apparatus for management is pointed in the wrong direction and urgently needs rethinking and redirection.* As management systems have developed, they have caused a loss of authority and control and have confused and vitiated the capacity of managers to carry out their main lines of delegated authority. In the process, management systems have all too often become generators of, or major contributors to, the overregulation and overburden of the managers role. The greater the number of procedural requirements to be met and the greater the number of people who have to be involved in any action, the less a manager can be held accountable for an action.

How Management Systems Weaken Management

What is most difficult for many people to understand is that *management systems are not management.* Such systems are tools for the use of managers, and in some cases, may help prevent bad management, but they cannot themselves create good management any more than a box full of expensive tools guarantees good craftsmanship. The major thesis of this report is that the most important and most effective way to achieve better management in government is to improve the performance of its managers and that to a large extent management systems not only fail to meet this test, but in fact have become dysfunctional from the manager's point of view. Following are the principal constituents of this thesis.

- *The design and control of management systems are too centralized, either within agencies or in the central agencies (OMB, OPM, GSA).* A large proportion of the issues and problems which this study identified center around this theme. For many reasons, the trend of recent years has been in the direction of greater centralism—that is, the concept that each system must be centrally defined and mandated by one of the central agencies for governmentwide use and then centrally enforced, with changes centrally controlled. Management failures often do not result in attempts to correct management problems, but in new legislation or regulation placing new restrictions or requirements on all agencies.

  This system does have advantages. It achieves a high order of uniformity and consistency of interpretation, and Presidents and Congresses have tended to regard central systems as easier to understand and hold accountable. Central agencies have often worked hard to exercise their stewardship in responsible ways.

  But the overwhelming view of managers is that centralism contributes to an overvaluing of the system itself at the expense of its usefulness to managers. Each system has its powerful central agency sponsor and defender, and each becomes the subject of laws and regulations which vest it with great authority. There is no comparable process at work which defends and guards the role of the operational manager. Governmentwide uniformity becomes a stronger motivation than flexibility. The use of systems as instruments of central control overpowers the need to delegate authority into the hands of the line manager. And equity (the concept that all actions must be handled in the same way) obscures the fact that management responsibilities differ vastly across government and could benefit greatly from flexible, adaptive systems.
- *Systems are too negative and constraining.* Federal management systems tend to be regulatory and proscriptive, to deal with process rather than substance, and to preclude deviations and flexibity. They are constructed to preclude certain bad management practices and not necessarily to foster good management. They employ essentially negative devices of constraint, regulation, compliance, inspection, review, etc.
- *Excessive checks and balances become counterproductive.* Checks and balances are essential in our form of government, and there have been enough examples of abuse of power to make this clear. The question, therefore, is not whether they are needed, but how much of such protection is required and how it can be brought to bear without impairing effectiveness. The Panel believes that the accumulation of such protections has, in total, become excessive and has often been represented as the answer to poor management in situations where the emphasis should more realistically have been placed on strengthening management. Highly cumbersome systems generate counterefforts to end run or circumvent them, or worse, to manipulate them, thus increasing the very abuses they are intended to curb.

  Client interests seek to lock in practices which they prefer and exclude alternatives. The technical masters of each system display a normal tendency to perfect their own product. Any single action may be justified in itself, but the cumulative effect has been to create systems which heavily constrain the capacity to manage.

"Systems have become sources of power, and efforts to change them become struggles for creation or transfer of power."

- *Systems are too rigid.* Systems have become sources of power, and efforts to change them become struggles for the creation and transfer of power. In the face of these conditions, attempts to change governmentwide systems have become highly complex efforts to negotiate consensus among conflicting internal interests. And, because most programs have major impact outside of government with client groups, state/local governments, contractors, and individual citizens, further broader consensus is often needed with these interests and usually with Congress as well. But, in fact, it has become almost impossible to negotiate change. Management systems issues lack a natural constituency in political terms, and even inside government, reform efforts are not popular. Even comparatively modest changes are beyond the managers' authority, and major investments of effort and political capital are required. Where central agencies are unwilling or unable to lead such efforts or where change efforts fail, management systems have experienced protracted periods of neglect and potential obsolescence.

- *Management systems are too "expensive."* Strong central systems become very demanding in terms of the people needed to run them and the paperwork requirements they impose on their users. They also require too much servicing and maintenance. The greatest cost, which is impossible to measure, the indirect cost of adverse impact on effective program operations.

The Top Priority: Restoring the Role of the Manager

The easy conclusion to draw from this diagnosis of management systems problems is that better and more extensive effort is needed to reform them and make them more effective. This report in fact draws that conclusion, and most of the recommendations in subsequent chapters are aimed at achieving that purpose. But a second, more serious, and more important conclusion to be drawn, which deals not with systems themselves but with managers, is stated as follows: *The major causes of the widely perceived decline in Federal management center not around systems or policy but around adverse impacts on people. In the context of this study, the people most concerned are line and staff managers, and the net effect of the overburden and overregulation which this report describes has been to seriously impair the tools with which they are equipped to do their jobs, the managerial flexibility they are permitted, and their motivations for high performance.*

"As systems have become dominant and controlling, managers have lost a vital capacity to adjust to what has been a very dynamic political and societal environment."

This report is full of examples of this kind of system frustration. The budget process, for example, is notorious for making major changes in programs or management responsiblities and then failing utterly to recognize the collateral changes needed in management funds or personnel to implement those changes. Program directors may make important grant or contract decisions only to see months pass while these actions languish in complex procurement or grant-making procedural pipelines. Huge backlogs of claims or appeals stack up in in-boxes because of detailed, complicated administrative procedures, inadequate workforces, and obsolete data-handling equipment. Managers who are trusted to sign off on multimillion dollar grants and contracts are not trusted to approve $100 travel vouchers for their staff. Managers who supervise hundreds or thousands of employees are not considered capable of selecting their own people. Field staffs who manage important programs are considered incompetent to judge what office space they require.

The general governmentwide preoccupation with big management control systems has forced managers into that same preoccupation, and far too great a proportion of the managers' time and energy is spent on attempting to cope with literally thousands of pages of the detailed "nitty-gritty" of these procedures. Managers clearly are not fully in charge because often systems are in control. The power to act and decide is broken up and diffused. Managers cannot be held fully accountable for their programs because important authorities are locked into external procedures which must be obeyed. As systems have become dominant and controlling, individual managers have lost a vital capacity to adjust to what has been a very dynamic political and societal environment. Instead of being responsive to client needs, they must defend the status quo or send urgent appeals for change up long tortuous staff channels to remote central agencies. Thus, where too much authority is taken away from the government's managers and lodged in externally controlled systems, a critical dimension of the effectiveness of those managers is lost. Both employees and outsiders see them as ineffective, and managers themselves lose motivation for high performance and instead often become frustrated and defensive.

". . . the leadership of the Federal government has failed adequately to understand the negative consequences of the cumulative effects of overelaborate and overregulated systems on the thousands of line and staff managers."

In the opinion of the Panel, the leadership of the Federal government has failed adequately to understand the negative consequences of the cumulative effects of overelaborate and overregulated management systems on the thousands of line and staff executives and managers who are the real strength in the implementation of public programs. In the preoccupation with creating and defending strong central systems, the manager in government has been made less effective and far less motivated to carry his or her organization to high levels of excellence and productivity.

It is truly amazing how little the Federal government as a whole perceives or understands about this critical human resource. Despite their critical value, Federal managers do not receive the kind of careful preparation for their jobs which characterizes the best of private sector companies. There is a serious lack in the Federal government of the kind of positive reinforcement, recognition, and prestige which is so widely used elsewhere to encourage managerial excellence. Instead, Federal managers are all too often seen as "the problem," and overly regulatory systems and procedures are built on lack of trust for the government's own leaders. Such systems may sometimes prevent bad management, but they cannot create good management.

The NAPA Panel concludes that the whole framework of current Federal management policy which emphasizes highly centralized and regulatory management systems is simply pointing in the wrong direction. The best approach to solving the present conditions of managerial overburden and deterioration lies not in further hardening of the central system controls but in a deliberate "turnaround" of this policy to one of finding positive, constructive ways to build up the role and capabilities of its managers. In this way thousands of people all over government can regain a sense of being fully "in charge" and accountable for their own responsibilities and be given positive motivations and assistance to revitalize their own performance and that of the organizations they lead.

CHAPTER TWO

Conditions for Sustaining Successful Management Reform

The NAPA Panel is convinced that, despite often valiant efforts to solve specific management problems, the last decade has been a period of declining managerial effectiveness in the Federal government. Efforts at improvement have been increasingly sporadic, poorly planned, and inadequately backed and staffed. Most importantly there is a wealth of evaluation and diagnosis of management problems which is simply not being effectively utilized, largely because the Federal government lacks the will and the capacity to agree on and implement its own reform.

". . . there is a wealth of diagnosis . . . which is simply not being used, largely because the Federal government lacks the will and the capacity to agree on and implement its own reform."

At the Panel's suggestion, the General Accounting Office studied 12 governmentwide management initiatives undertaken between 1970 and 1980. Their report concludes that these initiatives failed to achieve their objectives for a number of reasons: rapid turnover in Executive Branch leadership, a lack of real consensus on what constitutes good management, lack of careful implementation planning and execution, and lack of adequate staffing and management attention to management concerns. The report concludes that this record calls into question the viability of the current role of OMB.

Succeeding chapters of this report once again set forth an agenda of specific recommendations for reform. The Panel strongly believes that a vigorous and successful effort to act on these recommendations would greatly unburden Federal processes and benefit program performance without loss of essential policy direction. But the Panel also believes that the poor record of performance in recent years is symptomatic of deeper problems which must be addressed before the Federal government again becomes capable of taking full advantage of any management reform initiatives. What is urgently needed is a "turnaround program"—a strong, positive, continuing effort to modernize government and a deliberate strategy to restore the conviction that a fundamental rebuilding of the institutional capabilities of government is an urgent and valid public need.

The major conditions for bringing about this turnaround program are summarized below.

Energizing the Talent Base

The Federal workforce is a tremendous talent base. In terms of education, training, and experience, it is the equal of any government in the world and superior to most. Top private sector executives who have served in government usually leave with a new respect for the quality and capabilities of the Federal people with whom they have worked. Leaders in Congress learn to respect the knowledge and judgment of career people. Why then has this talent base not been more successful in maintaining the highest management standards? Part of the answer is revealed in the frustration which those managers themselves express about central management—the frequent lack of leadership, the spastic and transient interest in operations, the lack of help and followthrough on management problems, and tension between political and career leadership, especially during the first year of most incoming administrations. There are strong emotions too about the negative effects of rigid, heavy-handed, centrally controlled management systems. Individual managers and supervisors feel helpless to change these systems themselves or even to adapt and change their own local controls in the face of systemwide rigidities.

"Instead of a system which unleashes and motivates thousands of managers to improve their own effectiveness, we have a system of slow painful change in a few areas driven by central agency staff projects."

Generating management reform, governmentwide and from the top down, has had the unfortunate consequence of intimidating and frustrating agency management improvement initiatives. Instead of a system which unleashes and motivates thousands of managers and supervisors throughout government to improve their own effectiveness, we have a system of slow painful change in a few areas driven by central agency staff projects. Even when these central efforts are well conceived and intelligently pursued, they still deal with management problems on too narrow a base, and do not keep up with the total pace of change across all systems. There are also many good management improvement programs and projects within individual agencies, but many of these cannot be fully implemented without coming up against the constraints of some centrally defined system.

The most powerful answer which the NAPA Panel sees to the solution of pervasive government overburden and obsolescence is to create a new environment which seeks to shift the center of concentration and effort for management reform into the hands of a broad range of senior and mid-level managers and supervisors, and to use the authority of the President and the leverage of the central agencies to motivate this executive/manager level and support its initiatives.

Recent surveys of the attitudes of Federal employees continue to show that most like their jobs and believe them to be important and worth doing. But "the system" does not fare so well. Employees appear frustrated about the workings of their own management and feel that it is burdensome and ultimately negative and stifling. It would be difficult to overstate this sense of frustration—the feeling that Federal executives and managers have lost control over their own performance and have seen an unstoppable shift of authority toward systems controls which are too remote and unreachable. As a result, they feel that the system reduces their own effectiveness and impairs their ability to serve the public.

The critical elements of leadership in management appear to wither in the face of a preoccupation with process. The tools are endlessly "perfected"; the manager who is expected to use these cumbersome tools believes himself to be ignored. The picture which emerges is not just a loss of authority but a loss of motivation toward higher performance or adaptation to change. Management systems are not management. Systems regulations and constraints can help avoid some negative results, but they cannot produce achievement and success. The most serious consequence of the management systems which this report studied is perhaps the least measurable—the degree to which these overregulated and overburdened processes have stifled individual enthusiasm and initiative and substituted rigid central control for individual flexibility and innovation.

"Management systems are not management."

This same problem is evident when examined from outside the government looking in. Much of the criticism about Federal management comes from citizens or client groups, from state/local governments, and from contractors, all of whom either do business with the government or are the recipients of Federal grants or services. This criticism is recorded in many ways—Congress, the media, client group complaints, and internal evaluations, audits, and investigations—and while some of it is unwarranted, much of it is painfully true. Much of it deals not with big policy issues but with very routine practical problems, including backlogs, interminable procedural delays, complicated and burdensome paperwork, foul-ups, and poor customer service attitudes. But one of the great strengths of the career workforce is—or should be—that it is on the firing line and has direct contacts and links with its clientele. This workforce learns from its clientele and is usually the first to know what's wrong and what to do about it.

The public is entitled to demand good and effective service. Federal managers find it difficult to explain to the public why problems can't be solved or necessary corrections made because of controls and constraints from somewhere in the upper reaches of the bureaucratic hierarchy.

The future for the Federal government appears to be one of much more stringent budget and workforce limitations than in the recent past. This environment will put a great premium on ways to make the government more effective and productive. The NAPA Panel recognizes that the Federal workforce is not perfect and has its share of poor workers. But the performance capacity of the workforce often is left unchallenged and largely untapped. A most important condition for turning around the problems of Federal management is to change the motivations of this workforce and to bring it more fully into the management reform movement. This will be a long-term effort: problems which have been years in the making cannot be solved overnight. But this is the kind of reform which can begin immediately and which can have immediate payoff.

"Federal managers find it difficult to explain why problems can't be solved . . . because of constraints from somewhere in the upper reaches of the bureaucratic hierarchy."

Another critical condition is the quality of leadership—of both careerists and political appointees. The highly management-oriented nature of many Federal programs makes it urgent that people placed in top positions have the knowledge and experience to provide real management leadership and that their tenure in these positions be dependent upon their managerial performance.

It is beyond the scope or capabilities of this report to define how such a turnaround program can be done, but it is clear that the first move must be a signal of leadership and support from the government's political leadership. In this view, the NAPA Panel makes the following recommendations.:

- The President is urged to adopt as a guiding management policy of his Administration that efforts of individuals to improve management are wanted and encouraged at all levels in the Federal government and that his Administration is willing to consider changes in central management systems to free up managers to be more effective.

A new, stronger focal point for management leadership is needed and must be created.

- **The role of central management agencies must be shifted away from detailed regulation and control toward policy leadership and performance evaluation.**
- **Specific efforts should be initiated to evaluate each management system to identify and remove constraints on managerial effectiveness. Individual managers and supervisors must be persuaded that these efforts are real and not merely symbolic.**
- **The greatest care should be exercised in appointing into positions which require high management skills both political appointees and career executives who have genuine management experience and ability and who will be motivated to produce effective management results.**
- **Future changes to such systems must draw more fully on participation and help from program and staff managers so that they have a direct say in how these systems will be designed to serve their needs as managers. A very good model is the series of task forces being used by the Office of Federal Procurement Policy in its procurement reform program, where both procurement experts and program managers are helping to design procurement system changes.**

In summary, the greatest potential for releasing the Federal government from its present overburdened and overregulated management is to place a whole new concentration and emphasis on optimizing the role of the manager: centrally directed projects for reform should be designed to encourage and support a far larger array of initiatives throughout the agencies, consistent with a more clearly designed set of government objectives and strategies.

Creating Stronger Management Motivations for Political Leadership

It appears to be increasingly rare to find political leaders who have the experience to understand the need for management reform and the motivation to spend part of their precious time in coping with such problems. When political leaders are indifferent or even hostile to management changes, the career staff see them as high-risk ventures and are far less likely to advocate them. This is particularly true where changes can be achieved only by persuading one of the central agencies to act or by getting the Congress to change a law. In these political forums, even a very small political minus seems to outweigh substantial managerial pluses. This Panel believes that the public wants and expects serious efforts from its leadership to improve management; therefore, in the long run, good management is also good politics.

Even where Executive Branch political leadership does support management initiatives, the frequent change in leadership tenure, averaging roughly 18 months, often means that such support may vanish in midproject, with a high likelihood that the new appointees, once again preoccupied with their own political objectives, will fail to support management projects sufficiently to keep them alive. Soon, another election intervenes, and the cycle of proposals, education, and persuasion begins again. In this manner, months and years may pass, while Federal managers struggle to find among political leaders the right combination of interest, motivation, and timing which will actually cause reforms to be carried out, a combination which very rarely occurs.

"It appears to be increasingly rare to find political leaders who have the experience and the motivation to spend part of their precious time in coping with such problems."

This cycle helps to explain why inadequate management often has persisted without correction. When this happens, those affected by Federal programs become increasingly frustrated; they are simply unable to understand why decisive action never quite occurs. Often, when these frustrations cannot be adequately satisfied, interest groups will "flank" both the political and career managers and go to the White House or Congress to get action. The down side of this kind of political attention, however, has often been that, in trying to solve a narrow short-term problem, the creation of new laws or regulations locks in solutions which constrain management flexibility and build in obsolescence for the future.

In the Federal government, political leadership involvement in all matters, including management matters is very deep. It is therefore critical to find ways to encourage among politicians the kinds of motivations which will result in their support for continuing, sustained managerial reforms at a higher level of priority than presently experienced. How can this be done?

In the Executive Branch, the most relevant answer appears to be emerging in the context of the Reform '88 Project, with two objectives which should be strongly supported.

- Certain reform objectives are defined as Presidential initiatives, which not only gives them backing from the top but creates the political motivation for Cabinet Secretaries and other agency heads to give these initiatives priority in their agencies. This greatly reinforces the hand of those people in the agencies responsible for carrying out reform projects.
- Reform '88 has been explained as a strategy to achieve management reform for the longer term and it seeks deliberately to devise reforms which can survive political transitions. It is not possible to preempt future political decisions, but it is certainly feasible to design reform efforts so that they have sufficient value and credibility that future Administrations are likely to continue them. The Panel fully supports this intent and emphasizes that the success of fundamental management reform is heavily contingent on acceptance by political lead-

ers that management systems change is a continuous and often long-term process.

Recommendations:

- The NAPA Panel supports the intent of the Reform '88 Project to develop a management reform strategy for the long term and recommends that OMB maintain an inventory of approved management initiatives which it presents and justifies to future political leadership in the Executive Branch as a means of gaining their acceptance and continuity of support.
- The Assistant Secretary for Management Group and the Inspectors General (through the President's Council on Integrity and Efficiency) should be asked jointly to develop and maintain a system for an inventory and justification of management reform and management improvement projects in departments and agencies. The objective is to have these officials act as a continuing source of knowledge of management effectiveness activities and a neutral advocate of these activities with future political leadership on behalf of the overall government.
- The House Government Operations Committee and the Senate Government Affairs Committee should regularly be supplied with these inventories so that they may serve as an informed central point of reference in the Congress about important management initiatives which warrant Congressional support over the long term.

Strengthening the Institutional Base

Where management systems are as highly centralized as they are in the Federal government, the role of the central agencies is critically important. This report strongly advocates a turnaround in managerial philosophy which points toward maximum feasible reliance on and delegation to line program managers, plus a policy of galvanizing a broad range of these people toward greater efforts for management effectiveness. Yet even within this more decentralized concept, the role of the central agencies remains critical but different.

All of these central agencies are complex institutions, with responsibilities so broadly defined that almost any imaginable role is legally open to them. Each in its own way is a facilitator, a regulator, and a provider of services to the Federal establishment. Generalizations about them are difficult, since exceptions are easy to find and their perceived roles change over time.

However, the Panel believes that its assessment supports two important general conclusions:

- *The present central agency institutional base is too weak to sustain a continuing high level of governmentwide reform, and therefore this base must be strengthened.*
- *This strengthening must take place in specific ways which support the concepts of greater continuity of reform effort, greater decentralization and delegation of authority to managerial levels, and greater systems flexibility and simplicity.*

The central agencies of the Federal government will continue to play a key role in Federal management for the foreseeable future. Their strength and necessity lies in the fact that they are (or should be) agents for the President in carrying out his role as Chief Executive Officer of government in seeing that the laws are faithfully executed.

But whether or not the central agencies are carrying out specific initiatives of the President, there is a longer term continuing management leadership role which must be sustained. The role of the central agencies can be structured and defined so that it facilitates and supports a more balanced partnership with the executive agencies. While the charter of the study does not extend to a full analysis of the organization of the Federal government management roles, the conclusion is unavoidable that a stronger central agency organization to lead Federal management activities is a mandatory condition precedent to the success of such activities now and for the future. Without this stronger central leadership capability, we believe that the Federal government will continue to fail to realize the full potential of any of its efforts for future management reform. We further believe that this leadership is of equal importance, whether management intiatives emanate from the White House, the Congress, or from within the agencies themselves. The weakness of such leadership creates a clear pattern of decline in the effectiveness of central management systems. Unfortunately this tends to be translated into a related sense of neglect in agencies as well. The best central agency leadership is one which makes it clear that the value of effective management is very great and helps motivate and shape similar values all over government.

"The conclusion is unavoidable that a stronger central agency organization is needed to lead Federal management activities . . ."

The NAPA Panel has been forced to conclude that the Federal government's pressing needs for broad-based and continuing management reform cannot be achieved through the existing combination of OMB, OPM, and GSA organization and approach and that two major changes must be made.

First: The current management role of OMB should be transferred to a newly created Office of Federal Management reporting to the President, which would become the organizational framework for providing a more powerful and responsive leadership for management reform and improvement for the entire Federal government.

Second: The missions of the central agencies must be rebalanced to strengthen and revitalize the broad governmentwide policy and oversight roles which only they can perform and to deliberately divest themselves to the greatest extent possible of these rôles which involve centralized regulation and control. To achieve this second change:

- Central agencies must serve as the agent of the President in his role as Chief Executive Officer, advise the President on management matters, develop governmentwide management policies, and prepare recommendations to the President on crosscutting management policy issues.
- The central agencies should be responsible for Federal systems design, redesign, modernization, and improvement and for directing the use of uniform central systems, but only where a clear need can be demonstrated for such governmentwide systems as opposed to individual agency systems. Even then, the central agencies should mandate only those systems elements necessary to achieve reasonable consistency of purpose and uniform procedures where necessary. Directives should be redesigned to emphasize results or performance objectives and should avoid detailed procedures which attempt to structure the means by which objectives are achieved. This policy closely parallels the objectives of the current Reagan Administration program for regulatory reform. *The NAPA Panel advocates that the Federal government should adopt a policy for its internal operations in which the fullest and most complete delegations of both line and management systems authority not needed for the proper exercise of its redesigned central agency responsibilities should be made to the governmental unit where actual operational management is exercised.*
- The central agencies should build up their capability to provide the President with a full and continuous evaluation of the management systems of government—to know where they are not being effective and to identify how they must be corrected or improved. In a more decentralized environment, most agency improvements will be the responsibility of agency heads.
- Each of the central agencies must provide far more active leadership in management research, innovation, experimentation, and the introduction of new managerial technology. Each central agency should be given explicit statutory authority *and adequate resources* to conduct such research; to undertake management experiments, tests, or demonstration programs; and to fund such programs through contracts or interagency agreements. Indeed, every Federal agency would benefit from similar experimentation authority through its own enabling legislation.
- With respect to management in the departments and agencies, the central agencies should actively encourage and assist agency management reforms; and particularly in new or smaller agencies, they should provide direct assistance for management needs.
- Particularly for the immediate future, the central agencies should concentrate their efforts on making management systems and techniques more relevant and of greater direct support to Federal managers and on addressing the critical ways in which the managers themselves must be prepared to take on these more demanding roles.

Creating the Office of Federal Management

Since World War II, the pivotal role in Federal management matters has been assigned to the Office of Management and Budget and its predecessor organization, the Bureau of the Budget. BOB/OMB has attempted to maintain a general management capability along with its primary role as the President's budget staff. During several periods of its existence, the management organization has performed exceptionally well. It has successfully carried out management projects of importance to every President and has attempted to maintain a general stewardship over management activities throughout the Federal establishment.

In its earlier years, agencies came to rely on BOB/OMB as a key source of governmentwide initiatives for keeping Federal management modern and up to date. In recent years, however, there has been a growing concern that, even while OMB continues to be capable of occasional excellent performance, it has irretrievably lost its overall effectiveness as governmentwide leader in management matters. Students of BOB and OMB have always recognized that its primary concern on behalf of the President has been the Federal budget process. This had been regarded as both a strength and a weakness in terms of OMB's management role. It is a strength because the budget gives the OMB Director a powerful voice in all government activities, with direct and continuing access to the President, and powerful leverage to deal with agency heads from a position of strength. It has always been hoped and expected that these strengths would be brought equally to bear on the managerial agenda; and from time to time, depending on the President's own interests and the Director's sensitivity to management problems, this has been true. The disabling systemic weakness, however, has been that the budget and related national economic issues have usually proved to be all-consuming. In recent years it has become so intense that it has almost totally preoccupied critical OMB leadership, draining away time, interest, and staff from the managerial initiatives. Further, the annual focus on the budget and the lack of concern with management matters clearly has a chilling effect on many management initiatives. Therefore, even when an Administration such as that of President Reagan

". . . major reform efforts point out the fundamental fact that the Federal government suffers not from the failure to diagnose its problems, but from a failure to implement. . . ."

seeks to take the initiative for management reform across a broad front, it finds OMB no longer has the talent base nor the recognized capacity for leadership to sustain such major efforts.

Nor does it appear likely that, in the forseeable future, the budget preoccupation will decline, and therefore proposals and arguments for building up and revitalizing OMB's "management side" seem less hopeful and less realistic.

Meanwhile, the need for strong sustained management reform leadership becomes more pressing. The Reagan Administration's ambitious Reform '88 Project and the recently emerging findings of the President's Private Sector Survey on Cost Control serve only to emphasize the breadth of the management reforms which are needed and the paucity of the resources available to take implementing action. Both of these major reform efforts point out once again the fundamental fact that the Federal government suffers not from a failure to diagnose its management problems, but from a failure to implement the changes which it already knows it requires.

The NAPA Panel has been forced to conclude that the Federal government's pressing needs for broad-based and sustained management reform can best be accomplished by the creation of a new Office of Federal Management in the Executive Office of the President and reporting to the President, which should become the framework for providing a more powerful and responsive leadership for management reform and improvement for the entire Federal government.

What should be the broad role and purposes of the new Office of Federal Management?

- First, to optimize the role of the President as Chief Executive Officer of government.
- Second, to inform the public and the Congress of the imperatives for effective Federal management and to facilitate the relationships between the Congress and Executive Branch with respect to the machinery of government.
- Third, to instigate the development of sound, long-term management planning and policy governmentwide and in all agencies.
- Fourth, to lead the drive for a major improvement in the management capabilities of the government both centrally and in the departments and agencies.
- Fifth, to lead the drive for refurbishment of government management systems.
- Sixth, to take leadership in management innovation through experimentation, test and demonstration programs, and adoption of new management concepts and technology.

The Office of Federal Management should be given Presidential authority and sufficient resources to *implement management change*—either through its own resources or by preparing plans and proposals for Presidential approval which define and mandate the implementation of priority management reforms by other Federal agencies. This authority should include the capacity to establish (and if necessary, fund) task forces, special project offices, advisory groups, consultants, or other resources needed to carry out this implementation role.

The Office of Federal Management would inherit from OMB such important functions as the drafting of non-budget related Executive Orders, management circulars, and other means for conveying Presidential direction on management subjects. It would include the present Office of Federal Procurement Policy and would coordinate responses to GAO audits of governmentwide applicability. It would also administer the requirements of the Paperwork Reduction Act. It would represent the President in Congress in cooperation with the White House Congressional office on government organization and management matters and would coordinate preparation of Administration management related legislation.

The role described for the Office of Federal Management extends from strategy to implementation. It is intended to be the one organization to which the President can turn which can develop an overall, long- and short-term strategy for government management. But it must also be able to convert that strategy into action, largely in the form of specific management improvement programs and projects. Reform '88, the increasing volume of GAO and IG reports, the reports of the President's Private Sector Survey on Cost Control, and this NAPA study once again demonstrate that there is a backlog of unresolved management problems and a wealth of management improvement ideas and opportunities, all begging for the kind of broad-ranging, experienced, highly competent leadership which an Office of Federal Management could provide. Its institutional role must be to loosen up the system, dislodge entrenched interests, motivate the Federal workforce to greater effectiveness, and recreate the capacity to innovate. Its role should be to lead, to promote, and to assist—far less to regulate, control, or enforce. To fulfill these functions, its role must be clearly defined as a broad range of responsibilities of sufficient importance that the President will give its Director direct and continuing access and the stature and support needed to deal with Cabinet officers and the Congress. To carry out this role, the Office of Federal Management must be given a far stronger core of top leadership positions, a broader organizational structure, and a revitalized senior career staff of higher calibre and more stability, and of broader experience and institutional knowledge about government.

"The Office of Federal Management . . . is intended to be the one organization to which the President can turn which can develop an overall, long and short term strategy for government management."

Recommendation:

The NAPA Panel recommends that the President submit legislation for the creation of a new Office of Federal Management having the authorities and responsibilities described above.

This recommendation is not intended to reduce the capacity of the Office of Personnel Management or the General Services Administration to render services to the departments and agencies of the Executive Branch. However, the question must be answered as to the management policy roles of each of these agencies. OMB has always considered that its role and authority is Presidential and thus includes all activities of the government. This means that OMB has, in the past, involved itself in OPM and GSA responsibilities—regularly through the budget examination process and selectively with respect to management issues. This involvement has often caused apparent conflict or confusion. The NAPA Panel believes that the proposed Office of Federal Management should assume the management leadership responsibilities of OMB and should continue to serve as the single agency which can advise the President on all Federal management matters. There is no reason to believe that the new Office of Federal Management would impair these other central agencies, and each would continue to be fully responsibble for its own policy areas as defined by the President and relevant statutes. Said another way, the President would look to the Office of Federal Management for management policy and objectives for the whole government and—within that framework—to OPM and GSA for policy and implementation in their respective areas.

The whole pattern of conclusions and recommendations of this report rests on the premise that, if the Federal government really wants to achieve general and broad-based reform of its management and create an environment in which managerial excellence is demanded and expected, then it must place top priority on its managers rather than its systems. In the chapters on specific systems which follow, the general diagnosis of systems problems is more fully explained and illustrated. A large number of recommendations are made which would greatly unburden systems and make them more useful and flexible for managers to use. But the Panel recognizes that as systems are redesigned to place greater reliance on managers, there must be a recognition that, in many cases, managers themselves are ill-equipped and ill-prepared to fulfill these more demanding roles. There must therefore be a parallel and equally serious effort to upgrade managerial skills and to create a new climate of motivation and reinforcement at the highest levels of government.

The Panel also recognizes that many efforts for management reform founder because of the failure to implement action. It is not unreasonable to point out to these same Federal managers that they can become the most powerful means through which such reforms are accomplished. Much of what is proposed can be achieved if managers are willing to create their own initiatives and become a stronger force within government for solving the problems about which they have so long complained.

LOW-INCOME HOUSING TAX CREDITS

FRIDAY, APRIL 27, 1990

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
HUD/MOD REHAB INVESTIGATION SUBCOMMITTEE,
Washington, DC.

The subcommittee met at 9:30 a.m., in room SD-538, Dirksen Senate Office Building, Senator Bob Graham (chairman of the subcommittee) presiding.

Present: Senators Graham and Mack.

OPENING STATEMENT OF SENATOR GRAHAM

Senator **GRAHAM**. I call the meeting to order. Good morning. Senator Mack and I apologize for the late commencement, but we had a vote at 9:30. There is one quality that is consistent here in the Senate, and that is unpredictability, and we have already experienced that today.

Today our subcommittee will consider issues arising because housing for low-income families in this country is made available through both tax and nontax subsidies. One of the main Federal tax subsidies is the low-income housing tax credit that is permitted by section 42 of the Internal Revenue Code.

The principal Federal nontax subsidies currently available are grants distributed through the Community Development Block Grant Program, rental assistance payments made pursuant to section 8 of the U.S. Housing Act of 1937 and below market rate loans made by the Farmers Home Administration. The nontax subsidies also frequently include soft loans, grants or other assistance from State or local governmental agencies and private sector entities.

The combination of tax and nontax subsidies in order to finance low-income housing appears necessary in many or most housing markets of this country. There are many reasons for this. They include the dramatic decline in funds appropriated for Federal housing production programs during the past decade, a limit on the subsidy available from the low-income housing tax credit, the cost of long-term borrowed funds, and the existence in many housing markets of high construction costs and modest or low area median income.

The financing of housing with tax and nontax subsidies raises a number of significant public policy and administration issues. This morning's hearing and roundtable discussion will consider some of these. Today's agenda includes consideration of the following questions:

1. What data is now available regarding the use of low-income tax credits?

2. How can the net capital invested in credit-assisted low-income housing be maximized?

In considering the second question, we also want to discuss whether there are alternative, feasible means of inducing investment in low-income housing that are more likely than the tax credit to produce housing units at less cost.

3. How are the State housing agencies and HUD implementing the 1989 changes in the law that require that the tax credit subsidy and HUD's nontax subsidies be provided in an efficient manner that takes account of the availability of each type of subsidy?

4. What methods and resources are the State housing agencies and the IRS likely to employ to monitor and enforce compliance with the tax credit requirements, particularly the low-income family occupancy and habitability requirements that apply for a minimum 15 year period?

5. With the prohibition established in 1989 against the combination of tax credit subsidies and the section 8 moderate rehabilitation rent subsidy, what issues remain that are specific to the interplay between the tax credit and the section 8 subsidy programs?

To assist the subcommittee in analyzing these issues, we have assembled this morning a distinguished panel of participants representing the principal Federal agencies that are involved with resolving these issues, the General Accounting Office, and knowledgeable representatives of State housing agencies, for-profit project syndicators and nonprofit project syndicators.

Ladies and gentlemen, on behalf of the subcommittee, I welcome your participation and look forward to benefiting from your wisdom and experience.

In proceeding, we will first hear testimony and receive a report from the GAO that responds to questions raised at earlier hearings of the subcommittee and the full Banking Committee. Then we will proceed in a roundtable format. At the outset of that discussion, I would welcome comments by the other panel members on GAO's testimony. In the interest of having a full discussion of the issues, we will proceed with the roundtable discussion without opening statements; however, anyone who wishes to submit an opening statement for the record is welcome and encouraged to do so.

The ranking minority member of the subcommittee, my colleague and friend, Senator Mack. Connie, do you have a statement?

Senator MACK. Thank you, Senator Graham. I do have a prepared statement which I will just submit for the record, and just say that I am again pleased that we have so many individuals willing to assist us in our effort here and particularly Mark Hendrickson from Florida. It is good to see you again. We have had the opportunity to talk on a number of occasions. I look forward to your input. There are several folks who have been with us. It seems like maybe they have become part of the committee.

Let me just say also, Bob, I want to commend you for the hearings that we are holding. From time to time we don't have a large crowd in the audience, and the attention is—maybe the issue is not as sexy as some of the others, but I think from the hearings that we have had before and the opportunity to get into some discussions that really have to do with the planning and staffing and the controlling of HUD, I think have been very important and very vital, and I really compliment you on these hearings and the way that you've gone about these. So it's good to be with you again this morning and I look forward to the testimony.

[The complete prepared statement of Senator Mack follows:]

OPENING STATEMENT OF SENATOR CONNIE MACK

It's a pleasure to be here today. I look forward to today's discussion of low-income housing tax credits and appreciate the witnesses' willingness to participate, especially Mark Hendrickson from the Florida Housing Finance Agency.

To a fiscal conservative like myself, the tax credit seems like a good way of encouraging the private sector to build low-income housing. The problems we have encountered with this program, however, requires that we examine more closely its implementation.

The United States has a history of providing Federal housing subsidies through many different programs, some in cooperation with State and local funds. This multiplicity of programs has created a degree of complication that has made monitoring even more difficult and has resulted in widespread misuse of Federal funds, especially through "layering" of these many Federal subsidies.

I recall an earlier hearing where developers testified on how they combined different Federal programs to make a housing project work, to make it economically worthwhile. I remember how unbelievably complicated these deals became and wondered why a developer would even endeavor to take on these projects. While economic profitability was one incentive, certainly a commitment to improve their communities had to be an even greater incentive given the overwhelmingly problematic process associated with putting together an acceptable deal.

The tax credit has certainly provided important Federal assistance to these well-meaning developers who are indeed building low-income housing for the poor. There are those developers, however, who do not have this public service commitment and have instead taken advantage of the complicated process involved with financing low-income housing. In other words, Federal housing dollars intended for the poor went instead to developers.

As long as we in Congress continue to write complicated laws without proper monitoring, we will continue to waste millions of Federal dollars. Different programs, like the low-income tax credit, don't operate in a vacuum. They must be designed in the larger context of our overall housing policy.

Senator GRAHAM. Thank you very much, Connie. I appreciate those remarks. These have been very instructive. We started this process with the analogy that we were not looking at the rats; we were trying to understand the cheese, and we have gotten way inside the molecules of the milk with which that cheese is made, and today we are going to probe into another area.

It has been our practice in the past to have all of the witnesses sworn, so I would like to ask everyone who is going to participate today, if you would please rise and raise your right hand.

[Witnesses sworn.]

Senator GRAHAM. Mr. John Ols. Mr. Ols is one of those people Senator Mack was referring to who has become a regular participant in these hearings and a very valuable commentator on issues relating to the Department of Housing and Urban Development.

Mr. Ols, we look forward to receiving your report today. With you is Mr. John Weicher, Assistant Secretary for Policy Development and Research, Department of Housing and Urban Development.

STATEMENT OF JOHN M. OLS, JR., DIRECTOR, HOUSING AND COMMUNITY DEVELOPMENT ISSUES, U.S. GENERAL ACCOUNTING OFFICE, WASHINGTON, DC, ACCOMPANIED BY DENNIS FRICKE, ASSISTANT DIRECTOR

Mr. OLS. Thank you, Mr. Chairman. Dennis Fricke, who is my assistant director is with me, who led the assignment and has been working with your staff and with my staff to try to work our way through the maze of use of tax credits and the financing structure, which I must say, to my knowledge, as I have picked up, is really an involved process, and I think you are right on target in trying to look at how they are allocated, how we put those out on the market and then how we oversee to make sure they are accomplishing their intended objectives of serving the low-income housing population. And I really compliment the committee on where it is going.

What I would like to do is just briefly summarize the detailed statement provided for the record, and that way it will give us a chance to get on into the panel session and the dialogue that I think will take place.

Basically, as you know, the low-income housing tax program was created in the Tax Reform Act of 1986 and was intended to increase the supply of rental housing units for low-income families by using tax benefits to reduce equity investment to buy, build or rehabilitate such housing. Since the low-income tax credit began in 1987, use of the credits has steadily increased from about 18 percent of the total amount allocated to States in 1987 to about 98 percent of the allocation in 1989. By the end of 1989, about $560 million worth of initial year credits had been awarded in connection with the development of approximately 236,000 low-income housing units.

Syndication is the process of structuring financial arrangements to secure cash from outside investors. Most tax credit syndications have been conducted as public offerings with limited partnership interest and taxable projects being sold to individual investors. A number of syndications, however, are being conducted as direct placements usually to corporate investors.

When tax credits are used, as with any Federal assistance mechanism, costs are incurred. When the Federal Government issues tax credits, it incurs a tax expenditure equal to the tax revenues foregone. For low-income housing developments, some of the tax expenditures are used to attract equity capital so that investors can realize a competitive rate of return. The capital raised in this manner, however, is not completely available to directly invest in low-income properties. Expenses incurred to solve the partnership interest and certain fees for acquiring the properties are paid out to investors or paid for out of investors' equity, which reduces the amount available to fund the projects.

Reportedly, over the past 20 years most private investment in low-income housing has been through limited partnerships. In many instances, large investment houses accumulate a pool of funds from prospective investors and then look for projects to invest in. In other cases, a developer already has located a project and is looking for permanent financing. In either case, most financing generally comes from a bank or other lending institution in the form of a mortgage. The remainder of the financing often comes from the sale of ownership shares to limited partnerships to whom tax benefits of the project are passed.

An essential feature of any limited partnership is that the limited partner or partners have no role in day-to-day operations. This makes every limited partnership a passive activity for the purposes of Internal Revenue Code tax situations.

Special restrictive rules apply to the tax treatment of losses and credits produced by passive activities; however, passive activity rules do not apply to most corporations. Consequently, they can use passive tax benefits such as depreciation allowances and interest deductions not available to individuals.

Because of the many possible variations in the way individual syndications are structured, no one syndication or syndications are exactly alike, and it is difficult to characterize the typical syndication. However, two basic elements are associated with syndicated tax credits.

First, equity must be raised by attracting investors who contribute capital, a portion of which is used as the down payment on the project's mortgages in the expectation of receiving a return on their investments. To provide investors with this expected return for incurring certain risks, the amount of equity raised will be less than the tax credits paid out.

Second, syndication transaction or front-end cost such as selling commissions and organizational expenses must be paid. These costs are for services such as advertising, legal advice, printing, accounting and appraisals and for other costs associated with acquiring real estate such as title insurance and mortgage loan fees.

An oversimplified example is something I would like to walk you through now. We do have a chart with this on it on the right side of the room. [See attachment V to Ols' statement.] What we are talking about is $100 in tax credits to be paid over 10 years, which basically comes out to $1,000 worth of tax credits available over that period of time. We assume that the project is a new construction project, has no residual value and has no other Federal subsidy and the tax credits are the only source of return on investment. We made these assumptions basically for simplicity's sake to walk our way through the example of how the tax credit system plays out.

In order for the hypothetical project to have been awarded $1,000 worth of tax credits, about $1,111 would have to be spent on the project's development, not including the land costs. I should add that this same chart is the last page of my detailed statement, which might make it easier to focus on. For anybody who is in the audience, it is the same chart.

At the Federal Government's current cost of borrowing of about 8.5 percent average annual rate for 10 year Treasury notes, the $1,000 in tax credits have a present value of $712. With no other project benefits involved except the tax credit, an individual investor could realize a 13 percent rate of return after taxes by making a one-time payment of $613 in order to receive $100 worth of tax credits for each year for 10 consecutive years. Therefore, an immediate cost of raising the capital in this way is $99, which is the right first box on the flow chart there, which represents a difference between the present value of the credit, $712, and the price paid for the almost $613. I might add that 13 percent figure on rate of return in our discussions with various people involved in this can range anywhere from 10 percent as a low up to 22 percent, which will change some of the flow of the figures and some of the final computations, but we are using that for discussion purposes only.

This is compensation to the investor for risk incurred. On the basis of our preliminary work, we found that this public offering could range in that 10 to 22 percent area.

Front-end costs for syndications are paid from the amount of equity raised from investors. In a GAO report in July 1989, we found that the maximum amount of raised capital used to pay syndication fees and expenses varied considerably. On average the front-end costs of syndications for low-income housing are projected to account for a maximum of about 26.5 percent of the capital rates. Using our example and assuming a 3 percent working capital reserve of about $182 or 29.5 percent of the $613 raised, would be required to cover the transaction costs associated with the syndication. Accordingly, out of an original $1000 in tax credits with a present value of $712, $99 is the risk premium to attract capital from private investors, $182 is the estimated front-end costs. In this example then, $431 or about 60.5 percent of the present value of the tax credit would be left and potentially available as equity financing for the project.

And in my way of understanding that, as I worked with my tax specialists and the people that really worked their way through this maze of how the financing works, I would probably relate it to the fact that the $431 would be basically what I might have in my pocket to put down on a house, and then I have to get some more money through a mortgage or a financing arrangement, because that is not going to be enough to get me in the door to buy the house. That is how I look at it from a layman's standpoint.

In this example, $431 or about 60.5 percent of present value of the tax credit would be left and potentially available as equity financing for the project.

While this amount is significantly lower than the present value of the project's credit, it can be viewed as leveraging $680 of associated debt financing in order to bring the total capital investment into the project up to the $1101.

In conclusion, use of low-income housing tax credit programs has grown steadily since the program began, and the program now represents the Nation's primary effort to encourage low-income housing production. I would emphasize that it is the primary effort that we have going to encourage low-income housing production. The increased emphasis on the program requires it to be used as efficiently and effectively as possible. Recent legislative program changes place greater responsibility on State credit allocation agencies by requiring them to develop allocation plans for awarding credits. The legislation did not, however, clearly place responsibility on either HUD or state agencies for monitoring credit recipients' compliance with the program requirement. Officials of the IRS told us that their compliance monitoring efforts would address normal tax audit procedures but did not focus on housing issues such as tenant eligibility or whether projects that received credits conformed to housing standards.

I would like to just mention that under HUD's program when section 8's are involved, the PHA's have the responsibility to assure tenants' occupancy and whether they are qualified to meet certain rules and regulations and HUD then monitors PHA's carrying out that rule. However, when there is no section 8 involved, basically we have nobody overseeing that and there is no requirement, to my knowledge, in the law that says that anybody has had that responsibility assigned to them. One might think of it as IRS could do that, but that might be far afield from really what IRS's role is in taxes. And that is a policy issue to work our way through.

We could have the public housing authorities reporting to the state housing agencies and sharing what they found. This means that you could go back and recapture the credit if it wasn't used properly after the first 2 or 3 years or first 5 years, whatever that time period—10 to 15 years or 30 years, some way to make sure we are getting at the back end, not only at the front end when we are deciding to allocate it. We have to continue to make sure in a market where we have a great demand for public housing or low-income housing and a short supply that keeps going down that we make sure that this stays available for the public interest.

In this manner, as well as other issues associated with the use of the program will require further study to ensure that maximum program efficiences are achieved. For example, at this point, many questions remain unanswered.

Can transaction costs be used so that more of the investor's equity is potentially available for project development?

Can this be done without lessening syndicators willingness to package deals?

Should corporate investors be excluded because they can benefit from two separate tax subsidies—tax credits and the passive activity deductions?

How do the cost and benefits of other financing approaches for low-income housing, such as direct grants, compare with a program such as tax credits administered through the U.S. Tax Code?

Answers to these and many other related questions should be known before any major housing policy financing initiatives are undertaken.

In any event, if the existing tax credit program is to be continued on either a temporary or permanent basis, it is important that adequate controls are developed to ensure the projects that receive credits are maintained and operated in accordance with program requirements.

Projects that have been awarded credits should be carefully monitored to ensure that they continue to qualify for the annual credits by serving low-income families. Effective monitoring procedures, coupled with clearly defined responsibilities for compliance reviews and appropriate sanctions for noncompliance should be established to discourage program abuses.

Mr. Chairman, that concludes my summary, and we will be glad to try to answer any questions, and I do have some experts here from our office that deal in tax policy and know the economics of some of these problems that might be well beyond my comprehension.

[Complete prepared statement of John M. Ols, Jr., follows:]

United States General Accounting Office

GAO

Testimony

For Release on
Delivery
Expected at
9:30 a.m. EDT
Friday
April 27, 1990

Low-Income Housing Tax Credit Utilization and Syndication

Statement of
John M. Ols, Jr., Director
Housing and Community Development Issues
Resources, Community and Economic Development Division

Before the
Subcommittee on HUD/Moderate Rehabilitation Investigations
Committee on Banking, Housing, and Urban Affairs
United States Senate

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to assist the Subcommittee in analyzing the utilization of the low-income housing tax credit program. Today, I would like to discuss three issues. First, the amount of low-income housing tax credits allocated to states and awarded to projects for calendar years 1987 through 1989 and the number of low-income housing units developed in connection with these awards. Second, the syndication process used to assist in raising capital to finance low-income housing projects that have been awarded tax credits. And, third, the net amount of equity capital raised through the syndication of projects awarded tax credits relative to the amount of the credit award.

Tax credits are intended to induce investors to supply equity for low income housing. Since the low-income housing tax credit program began in 1987, award and use of the credits has steadily increased from about 20 percent of the total amount allocated to states in 1987 to about 98 percent of the allocation in 1989. By the end of 1989, about $565 million worth of initial-year credits had been awarded in connection with the development of approximately 236,000 low-income housing units. The credit program now represents the federal government's primary subsidy for encouraging low-income housing production.

Syndication is the process of structuring financial arrangements to secure cash from outside investors. Most tax credit syndications have been conducted as public offerings with limited partnership interests in tax-credit-eligible projects being sold to individual investors. A number of syndications, however, are being conducted as direct placements, usually to corporate investors.

When tax credits are used, as with any federal assistance mechanism, costs are incurred that are necessary to attract and manage funds. When the federal government issues tax credits, it incurs a tax expenditure equal to the tax revenues foregone. For low-income housing development, some of the tax expenditures are used to attract equity capital so that investors can realize a competitive rate of return. The capital raised in this manner, however, is not completely available to directly invest in low-income properties. Expenses incurred to sell the partnership interests and certain fees for acquiring the properties are paid for out of investors' equity which reduces the amount available to fund the projects.

PROGRAM BACKGROUND AND TAX CREDIT UTILIZATION, 1987-89

As you know, the Low-Income Housing Tax Credit Program was created in the Tax Reform Act of 1986 and was intended to increase the supply of rental units for low-income families by using tax benefits to induce equity investment to buy, build, or rehabilitate such housing. Projects that were awarded credits prior to 1989 had to be used as low-income housing for a 15-year period or they were subject to recapture of a portion of the credit award. However, because of uncertainties about how the program worked and reservations about the usefulness of the program, initially few developers participated. With increased familiarity, tax credit usage has steadily grown, and now represents the federal government's primary low-income housing production subsidy.

Recently, Section 7108 of the Omnibus Budget Reconciliation Act of 1989 (P.L. 101-239) extended the program through calendar year 1990. This legislation permits the Treasury Department to redistribute unallocated credits to states that need them. It also extended from 15 to 30 years the maximum length of time that a credit-eligible project would have to be used for low-income housing. It also placed greater responsibility on state credit allocation agencies by requiring them to develop allocation plans for awarding credits. These plans are to set forth project selection criteria, and selection preferences and priorities. The legislation did not, however, clearly place responsibility on either HUD or state agencies for monitoring credit recipients' compliance with program requirements. Officials of the Treasury Department told us that their compliance monitoring efforts would address normal tax audit procedures, but not focus on housing issues such as tenant eligibility or whether projects that received credits conformed to housing standards.

The amount of credits awarded by state agencies to projects is partly determined by calculating a percentage of the project's acquisition and rehabilitation costs. The credit award can vary depending on whether subsidized, or below-market rate financing or tax-exempt bonds are used for project development. In addition, numerous other considerations, such as the availability of unused credit allocation, determine the amount of credit ultimately awarded to a given project.

In 1987, the first full year of the tax credit program, states were authorized, on the basis of $1.25 of credit per capita, to allocate about $313 million in tax credits to eligible projects. However, only about $63 million in credits, or about 20 percent of the authorized amount, was awarded to about 34,000 housing units. In 1988, the use of credits had increased to about $202 million for assistance to about 78,000 units. By 1989, of a total authorization of $314 million, $307 million, or about 98 percent, was allocated to about 125,000 low-income housing units. For 1990 only, the per capita rate of credit for each state is 93.75 cents. Attachment 1 provides a summary of the use of credits for years 1987-89. Attachments 2 through 4 show the use of credits, by state, for the same period.

Also shown in the attachments are the types of projects assisted using tax credits. For the entire period from 1987 to 1989, nearly half of the credits awarded were used in connection with newly constructed low-income housing; about one-fourth for substantial rehabilitation projects; and the remainder for either the acquisition or acquisition and minor rehabilitation of existing low-income projects.

According to information for calendar years 1987 and 1988, the only years for which this information is available, about 82 percent of the projects that received credits were small projects consisting of 50 or fewer units. In addition, about 62 percent of the projects that received credits also received other federal subsidies such as HUD Section 8 rental subsidies.

SYNDICATING LOW-INCOME HOUSING AND THE EFFECT OF PASSIVE ACTIVITY RULES

Reportedly over the past 20 years, most private investment in low-income housing has been through limited partnerships. In many instances, large investment houses accumulate a pool of funds from prospective investors and then look for projects to invest in. In other cases, a developer already has located a project and is looking for permanent financing. In either case, most financing generally comes from a bank or other lending institution in the form of a mortgage. The remainder of the private financing often comes from the sale of ownership shares to limited partners to whom tax benefits of the project are passed.

Often, large investment houses accumulate a pool of funds from prospective investors and look for projects to invest in. The process of creating and marketing limited partnerships to acquire, develop, or operate real estate investment property is called syndication. Limited partnership interests in tax-credit-eligible projects are usually sold to outside investors who, in the hope of realizing tax or other project benefits, invest in the project syndications.

Another way the market operates is that syndicators prepare a plan for the project(s) projecting cash requirements, development costs, cash income flows, projected deductible losses and depreciation (if any), and tax credits available to investors. The price of a share is then fixed at a level that provides investors with a projected return sufficient to induce them to participate given the risk associated with the deal. The shares are then marketed by making them publicly available through an underwriter or broker, or they are privately placed by the syndicator. In this manner, tax credits awarded to a project can be used to raise capital that the project developer can use to help finance the project. As we reported last August, these individual partnership sales can increase the developer's gains from the project.

An essential feature of any limited partnership is that the limited partner or partners have no role in day to day operations. This makes every limited partnership a passive activity for the purposes of the Internal Revenue Code. Special restrictive rules apply to the tax treatment of losses and credits produced by passive activities.

Under general principles of partnership law, limited partners may share, proportionately to their investment, in any profit or loss the partnership business produces. Accordingly, limited partners can deduct partnership losses and offset tax liabilities with any tax credit on their individual income tax returns. This led to the creation of many limited partnerships as tax shelters. The Tax Reform Act 1986 eliminated many tax shelters by prohibiting individuals from deducting losses derived from a passive activity.

However, the Congress created exceptions, including one for low income housing tax credits. Limited partners are allowed to deduct up to $25,000 in losses from residential rental property on the basis of a lesser participation requirement.[1] Under a special rule, investors in low income housing tax credit partnerships are allowed to take the equivalent of a $25,000 deduction in tax credits derived from the same passive activity. A $25,000 deduction for a taxpayer at the 33% marginal rate would yield a reduction in tax liability of $8,250. Accordingly, the maximum low income housing tax credit that any individual can use, or is likely to seek in one year is $8,250.

The passive activity rules just described apply to individual taxpayers, but do not apply to most corporations. A corporate investor can make a larger investment because a corporation can receive and use passive losses without the limitations that apply to individuals. They can also use other passive tax benefits such as depreciation allowances and interest deductions not available to individuals. This is a reason most direct placements (large amounts of investment and related tax benefits offered to one or a few investors) are made to corporations.

Syndication Structures Vary Widely

Low-income housing tax credit syndications can be structured in many different ways. The simplest form consists of a developer who owns and develops a project and who creates a limited partnership in which he will participate as a general partner. With the assistance of a syndicator, the developer/general partner finds investors and offers them interests as limited partners. In a more complex and more typical arrangement, a two-tiered partnership is formed. The pool of investors brought together by the syndicator is organized as a limited partnership, and that limited partnership in turn invests as a limited partner in one or more developer/project level limited partnerships.

---

[1] Originally, the entitlement to a deduction and to a low-income housing tax credit equivalent was phased out for taxpayers with incomes over $200,000 and reached 0 for taxpayers with incomes over $250,000. The 1989 amendments to the Code, however, lifted the phase out for low-income housing tax credits.

Depending on the terms of the partnership arrangement, various costs, benefits, and obligations can be structured to meet the requirements of the various parties to the partnership. For example, some syndications may be structured so that all partners fully share in and distribute realized appreciation, or increase in value, (if any) of acquired properties at the end of the syndication period. Other syndications may limit the amount of appreciation limited partners may share in. On the other hand, some syndications may be structured to provide for a return of the limited partners' original investment at the end of the syndication period. Still other syndications may provide only for the distribution of annual benefits to the limited partners with no lump-sum repayment of investment at the end of the syndication period. In addition to these variations, many syndications are structured to allow for reduced payments of investment proceeds if specified project operating goals or targets are not met.

COSTS ASSOCIATED WITH SYNDICATING TAX CREDITS

Because of the myriad possible variations in the way individual syndications are structured, no two syndications are exactly alike, and it is difficult to characterize the "typical" syndication. In addition, precise cost data for low-income housing tax credit syndications is not available because the partnerships are usually formed for a 15-year period including the 10-year period over which awarded tax credits are used by eligible projects. Because the tax credit program has been in existence for only 3 years, no partnership formed to invest in credit projects has reached the end of its partnership term. Therefore, precise, actual data on investor yields and some of the syndication costs cannot be known at this point.

However, two basic elements are associated with syndicating tax credits. First, equity must be raised by attracting investors who contribute capital, a portion of which is used as the downpayment on the projects' mortgages, in the expectation of receiving a return on their investment. To provide investors this expected return for incurring certain risks, the amount of equity invested will be less than the amount paid out in the form of tax credits, net operating cash proceeds, and any residual value of the property. Second, syndication transaction, or front end costs, such as selling commissions, offering, and organizational expenses must be paid. These commissions and expenses are for services such as advertising, legal advice, printing, accounting, and appraisals; and for other costs associated with acquiring real estate such as title insurance and mortgage loan fees.

Tax Expenditure Used to Attract Private Investor Capital

Private investors are willing to invest in a syndicated limited partnership because of their expectations about earning a return on their investment. This expected return is typically expressed as an estimate of an annual percentage rate of return, or yield for a specified amount of invested capital into the fund. For low-income project syndications, this rate of return is often (though, not always) assumed to come primarily from the tax benefits of the credits awarded to the project. The projects are usually heavily leveraged and often do not generate other significant sources of potential return on investment such as net positive cash flows from operations. In addition, some syndicators we talked to told us that they often assume a zero residual value at the end of the syndication period, particularly since the maximum compliance period has been extended to 30 years. Under these assumptions virtually all the investors' return must come from the projects' tax benefits.

Under this type of syndication deal, for a payment into the fund, an investor expects to receive annual allocations of credits (over the 10-year term of the project's credit award schedule) that reduces the investor's tax liability in an amount that represents the value of his capital contribution plus an extra amount that represents the investors' expected return.

As an over-simplified example, let's discuss a hypothetical project that has been awarded $100 in tax credits to be paid each year over the next ten years. This award will make $1,000 worth of tax credits available over the next ten years. As previously noted, syndication funds are often large pools of funds that are amassed to purchase interests in many projects that individually conform to the yield expectations of the syndicators. However, to clearly demonstrate the concepts involved, we are using an illustration that consists of one hypothetical project.

For our example, we will assume that the project is a new construction project, has no residual value, has no other federal subsidy, and the tax credits are the only source of return on investment. In order for the hypothetical project to have been awarded $1,000 worth of tax credits, about $1,111 would have to be spent on the project's development, not including land costs. At the federal government's current cost of borrowing (about 8.5 percent average annual rate for 10-year Treasury Notes), the $1,000 in tax credits have a present value of $712.

With no other project benefits involved except the tax credits, in this example, an individual investor could realize a 13-percent rate of return (after-tax) by making a one-time payment of $613 in order to receive $100 worth of tax credits for each year for 10 consecutive years. Therefore, an immediate cost of raising capital in this way is $99, which represents the difference between the present value of the credits and the price paid for them and is compensation for the investor for risk incurred.

On the basis of our preliminary work, we found that for public offerings, current yields to investors in low-income projects are projected to range from about 10 to 22 percent, depending on many factors such as the type of low-income housing involved, investor perceptions about projects' risk, and project financing structures. The higher the required projected yield, the less capital that will be raised from investors for the same amount of tax credits unless other project benefits, such as positive cash flows, contribute to the yield.

Transaction Costs for Public Offerings

Front end costs for syndications are paid from the amount of equity raised from investors. In a July 1989 report,[2] we found that the maximum allowable proportion of raised capital used to pay syndication fees and expenses varied considerably. Depending on the syndicator and complexity of the deal, the maximum allowable fees specified in partnership prospectuses varied from about 17 percent of the capital raised to about 34 percent for the 19 publicly-available partnerships we examined that marketed low-income housing tax credits. On average, the front end costs of syndications for low-income housing are projected to account for a maximum of about 26.5 percent of the capital raised. Actual costs are expected to be somewhat less than the maximum allowances. In addition, some syndicators also require a working capital reserve of 3 to 5 percent of the capital raised. According to industry analysts, the proportion of fees and expenses spent by publicly offered low-income housing tax credit partnerships are generally within guidelines promulgated by the North American Securities Administrators Association, Inc.

---

[2] TAX POLICY: Costs Associated With Low Income Housing Tax Credit Partnership (GAO/GGD-89-100FS).

Using our example above, and assuming a 3-percent working capital reserve requirement, about $182, or 29.5 percent of the $613 raised, would be required to cover the transaction costs associated with the syndication. For purposes of this example, these front end costs are assumed to be non-qualified credit expenses. Accordingly, out of an original $1,000 in tax credits with a present value of $712, $99 is the risk premium to attract capital from private investors; and $182 is the estimated front end cost. In this example, then, $431, or about 60.5 percent of the present value of the tax credits would be left and potentially available as equity financing for the project. (See flow chart on attachment 5). While this amount is significantly less than the present value of the project's credits, it can be viewed as leveraging $680 ($1,111-$431) of associated debt financing in order to bring the total capital investment into the project up to $1,111.

The amount of capital raised and potentially available for project development, however, is highly dependent on such factors as investor yield requirements, and assumptions about whether investors' initial capital contributions are returned to them at the end of the syndication. Using the same example above, let's now assume that investors would accept a 10-percent yield instead of 13, and that their initial capital contribution was returned to them at the end of the syndication period. Under these assumptions, the amount of capital raised would be $795, and with the same percentage of front end costs, the amount of capital raised that would be potentially available for the project would be $559. If investors required a 15-percent yield, capital raised and potentially available for the project would be $444.

Direct Corporate Placements

As in the case of public offerings, some portion of the value of the credits would be used to attract corporate investments in low-income housing syndications. However, for direct corporate placements, expected investor yields typically consist of at least two components. First, because the corporate investor is usually exempt from passive activity restrictions, any purchases of low-income housing tax credits are fully usable by the corporation to reduce its corporate income tax liability. Second, unlike individual investors, corporate investors can also fully use any project operating benefits, such as depreciation and interest deductions, as a reduction of any corporate income. Therefore, unlike individual investors, corporate investors in low-income housing can benefit from two separate tax subsidies--the tax credits and the passive activity deductions.

We were told that, because they have more investment options and opportunities than individual investors, corporate investors generally seek higher yields from their investments than individuals. When investing in tax credit projects, corporate investors can typically realize higher yields for the same investment because they can also use other project benefits such as depreciation in addition to the yield attributable to the credits. Corporate investors we contacted told us that required total yields are projected to range from 15 to 20 percent.

Officials of organizations that usually syndicate projects using direct placements told us that the transaction costs for these deals were generally projected to be considerably less than for public offerings. They said that the transaction costs, as a percentage of the capital raised, ranged from about 8 to 15 percent, including a typical working capital reserve of 3 to 5 percent. Direct placement syndicators told us that their transaction costs were generally smaller than those of public offering syndicators. They said that while certain costs, such as legal and accounting fees were comparable to the costs associated with public offerings, other costs, such as offering and selling expenses were considerably less when selling to a single investor.

We have performed limited work regarding the front end costs of direct placements to corporate investors for six partnership offerings. Four of these partnerships appeared to have fees and expenses as a proportion of equity that were similar to those of the publicly offered partnerships. Two of the six offerings had costs and fees lower than the other offerings. However, there was not sufficient information to account for the differences among fees and expenses.

CONCLUSIONS

Use of the low-income housing tax credit program has steadily grown since the program began, and the program now represents the nation's primary effort to encourage low-income housing production. The increased importance of the program requires that it be used as efficiently and effectively as possible. Recent legislative program changes, extending the program through calendar year 1990, also could enhance the program's effectiveness.

However, it is not possible to know in advance the amount of new housing construction or rehabilitation that will be generated by a given amount of tax credits made available. Each syndication will provide equity to support a single property or a pool of properties that will have widely varying yield structures. While tax credits will generate equity investments, and one can estimate the value of taxes foregone to attract the investments, and precise data on actual yields can only be known after syndications have been liquidated. Further, it is not known how many credit projects have an economic viability that would have generated equity investments in the absence of the tax credits.

Many issues associated with the use of the program will require further study to ensure that maximum program efficiencies are achieved. For example, at this point, many questions remain unanswered.

-- Can transaction costs be reduced so that more of the investors' equity is potentially available for project development? Can this be done without lessening syndicators' willingness to package deals?

-- What would be the implications of limiting tax losses by excluding corporate investors who receive more tax benefits than individuals?

-- How do the costs and benefits of other financing approaches for low-income housing, such as direct grants, compare with a program such as tax credits administered through the U.S. tax code?

Answers to these and many other related questions should be known before any major housing policy financing initiatives are undertaken.

In any event, if the existing tax credit program is to be continued on either a temporary or permanent basis, it is important that adequate controls are developed to ensure that projects that receive credits are maintained and operated in accordance with program requirements. Projects that have been awarded credits should be carefully monitored to ensure that they continue to qualify for the annual credits by serving low-income families. Effective monitoring procedures, coupled with clearly defined responsibilities for compliance reviews and appropriate sanctions for non compliance, should be established to discourage program abuses.

--- --- --- --- ---

Mr. Chairman, this concludes my statement. I would be pleased to respond to any questions that you or members of the Subcommittee may have.

ATTACHMENT I

ATTACHMENT I

NATIONAL SUMMARY OF TAX CREDIT ACTIVITY

	Year			
	1987	1988	1989	Total
Tax credit authority	$313,113,750	$303,887,310	$314,230,800	$931,231,860
Tax credit allocation *	62,885,954	202,227,453	307,320,726	572,434,113
Percent of authority used	20.08	66.55	97.80	61.47
Total/Units	38,164	91,062	133,887	263,113
Low-income credit units	34,491	77,825	124,518	236,834
Breakout of low-income credit units				
New Construction	14,455	33,947	62,590	110,992
Substantial Rehab	10,895	20,038	26,533	57,466
Acquisition / Rehab	2,595	13,073	21,962	37,630
Acquisition Only	6,546	10,767	13,433	30,746
Breakout of Low-Income Credit Units (percentage)	100.00	100.00	100.00	100.00
New Construction	41.91	43.61	50.26	46.86
Substantial rehab	31.59	25.75	21.31	24.26
Acquisition/rehab	7.52	16.80	17.64	15.89
Acquisition only	18.98	13.83	10.79	12.98

Source : National Council of State Housing Agencies /
Urban Institute Low Income Housing Tax Credit Survey.

* This is the cost for the first year, this cost is incurred for each of the next 10 years.

STATE SUMMARY OF TAX CREDITS USAGE IN CY 1989

Agency	Authority	Percent used	Credit units
Alabama	$ 5,158,750	99.93	2,676
Alaska	641,250	71.06	375
Arizona	4,561,250	91.01	1,414
Arkansas	3,027,500	78.78	224
California	35,210,000	99.57	7,960
Colorado	4,112,000	99.67	1,514
Connecticut	4,017,500	100.00	587
Delaware	825,000	100.00	212
District of Col.	782,500	100.00	202
Florida	15,471,250	100.00	5,600
Georgia	8,001,250	100.00	3,179
Hawaii	1,366,000	100.00	268
Idaho	1,248,750	100.00	490
Illinois	9,372,842	99.52	3,407
Illinois-Chicago	5,021,900	100.00	1,866
Indiana	6,968,750	99.69	3,188
Iowa	3,500,000	100.00	2,099
Kansas	3,108,750	100.00	0
Kentucky	4,651,250	100.00	2,973
Louisiana	5,525,000	99.89	3,493
Maine	1,507,500	100.00	718
Maryland	5,805,000	100.00	1,880
MA., EOCD	7,391,250	100.00	1,534
Michigan	11,625,000	100.00	5,248
Minnesota	5,382,500	100.00	2,039
Mississippi	3,283,750	100.00	2,144
Missouri	6,424,000	99.85	3,260
Montana	1,005,944	38.56	135
Nebraska	2,001,250	100.00	966
Nevada	1,325,000	100.00	697
New Hampshire	1,371,250	80.58	424
New Jersey	9,650,000	100.00	1,889
New Mexico	1,887,500	100.00	886
New York HDC	1,300,000	100.00	89
New York DHCR	22,372,500	99.77	4,553

ATTACHMENT II

ATTACHMENT II

Agency	Authority	Percent used	Credit units
New York MLEAC	1,628,489	100.00	1,164
North Carolina	8,109,000	99.83	3,469
North Dakota	828,750	94.67	358
Ohio	13,590,000	99.01	9,414
Oklahoma	3,670,875	78.75	2,374
Oregon	3,426,250	100.00	1,506
Pennsylvania	15,033,750	100.00	5,227
Puerto Rico	4,115,000	88.74	1,076
Rhode Island	1,243,750	100.00	355
South Carolina	4,366,250	100.00	2,089
South Dakota	893,750	100.00	553
Tennessee	6,148,750	99.96	3,004
Texas	20,975,000	93.94	16,425
Utah	2,100,000	90.00	490
Vermont	695,000	100.00	461
Virgin Islands	140,000	90.23	48
Virginia	7,518,875	100.00	2,363
Washington	5,825,875	98.90	2,418
West Virginia	2,355,000	60.69	710
Wisconsin	6,072,500	100.00	2,800
Wyoming	590,000	4.67	25
Total	$314,230,800	97.80	124,518

Source : National Council of State Housing Agencies /
Urban Institute Low-Income Housing Tax Credit Survey.

STATE SUMMARY OF TAX CREDITS USAGE IN CY 1988

Agency	Authority	Percent used	Credit units
Alabama	$5,103,750	23.14%	877
Alaska	656,250	0.00%	0
Arizona	4,232,500	76.89%	1,091
Arkansas	2,985,000	26.73%	559
California	34,578,750	54.63%	5,657
Colorado	4,120,000	85.01%	828
Connecticut	4,013,750	99.97%	1,032
Delaware	777,500	100.64%	819
District of Col.	805,000	45.42%	171
Florida	15,028,750	77.44%	4,716
Georgia	7,777,500	99.93%	3,658
Hawaii	1,353,750	3.40%	18
Idaho	1,247,500	101.60%	600
Illinois *	11,980,410	50.72%	1,957
Indiana	6,913,750	28.69%	478
Iowa	3,542,500	12.51%	414
Kansas	3,095,000	100.00%	1,054
Kentucky	4,658,750	52.41%	462
Louisiana	5,576,250	57.17%	2,543
Maine	1,483,750	90.00%	618
Maryland	5,668,750	100.00%	2,323
Massachusetts	7,318,750	100.00%	1,730
Michigan	11,500,000	88.78%	3,940
Minnesota	5,307,500	75.50%	1,700
Mississippi	3,281,250	36.39%	906
Missouri	6,378,750	95.41%	2,747
Montana	1,011,250	20.42%	102
Nebraska	1,992,500	85.66%	685
Nevada	1,258,750	57.51%	397
New Hampshire	1,321,250	68.12%	223
New Jersey	9,590,000	67.26%	1,552
New Mexico	1,875,000	100.00%	802
New York HDC			940
New York SDHCR *	21,281,250	100.00%	3,862
North Carolina	8,016,250	66.79%	2,635

Agency	Authority	Percent used	Credit units
North Dakota	840,000	5.27%	47
Ohio	13,480,000	54.09%	4,294
Oklahoma	4,090,000	42.06%	1,273
Oregon	3,405,000	99.90%	874
Pennsylvania	14,920,000	30.16%	1,519
Puerto Rico	3,995,650	92.18%	1,179
Rhode Island	1,232,500	100.00%	361
South Carolina	4,281,250	67.52%	1,759
South Dakota	886,250	29.31%	227
Tennessee	5,068,750	57.06%	1,455
Texas	20,986,250	50.31%	5,127
Utah	2,100,000	10.05%	99
Vermont	685,000	100.00%	274
Virgin Islands	140,000	96.34%	44
Virginia	7,380,000	82.09%	1,925
Washington	5,672,500	68.21%	2,032
West Virginia	2,371,250	76.52%	716
Wisconsin	6,008,750	90.15%	2,334
Wyoming	612,500	83.53%	190
Total	$303,887,310	66.55%	77,825

* Ill-Chicago DOH $7,600,000 and New York MLEAC $7,600,000 not included in state total authority

Source : National Council of State Housing Agencies /
Urban Institute Low-Income Housing Tax Credit Survey

STATE SUMMARY OF TAX CREDITS USAGE IN CY 1987

Agency	Authority	Percent used	Credit units
Alabama	$5,000,000	23.94	443
Alaska	670,000	9.30	22
Arizona	4,150,000	14.23	249
Arkansas	2,570,000	10.89	219
California	33,730,000	15.09	2,497
Colorado	4,080,000	95.75	1,581
Connecticut	3,990,000	11.92	191
Delaware	790,000	14.42	144
District of Col.	780,000	89.10	356
Florida	14,590,000	9.15	1,251
Georgia	7,630,000	19.93	1,342
Hawaii	1,330,000	0.00	0
Idaho	1,250,000	2.56	32
Illinois *	14,477,500	4.11	755
Indiana	6,880,000	11.67	413
Iowa	3,560,000	4.95	0
Kansas	3,080,000	67.37	1,263
Kentucky	4,660,000	41.55	1,899
Louisiana	5,630,000	25.68	1,041
Maine	1,470,000	14.31	96
Maryland	5,580,000	21.29	594
Massachusetts	7,290,000	58.87	1,361
Michigan	11,430,000	8.95	731
Minnesota	5,241,250	34.42	921
Mississippi	3,280,000	20.11	512
Missouri	6,330,000	29.38	1,065
Montana	1,020,000	61.11	170
Nebraska	2,000,000	15.99	176
Nevada	1,200,000	94.48	445
New Hampshire	1,280,000	3.10	31
New Jersey	9,525,000	14.43	378
New Mexico	1,850,000	43.46	323
New York HDC	7,600,000	100.00	917
New York SDHCR	22,220,000	5.42	1,059
North Carolina	7,910,000	17.02	741

ATTACHMENT IV

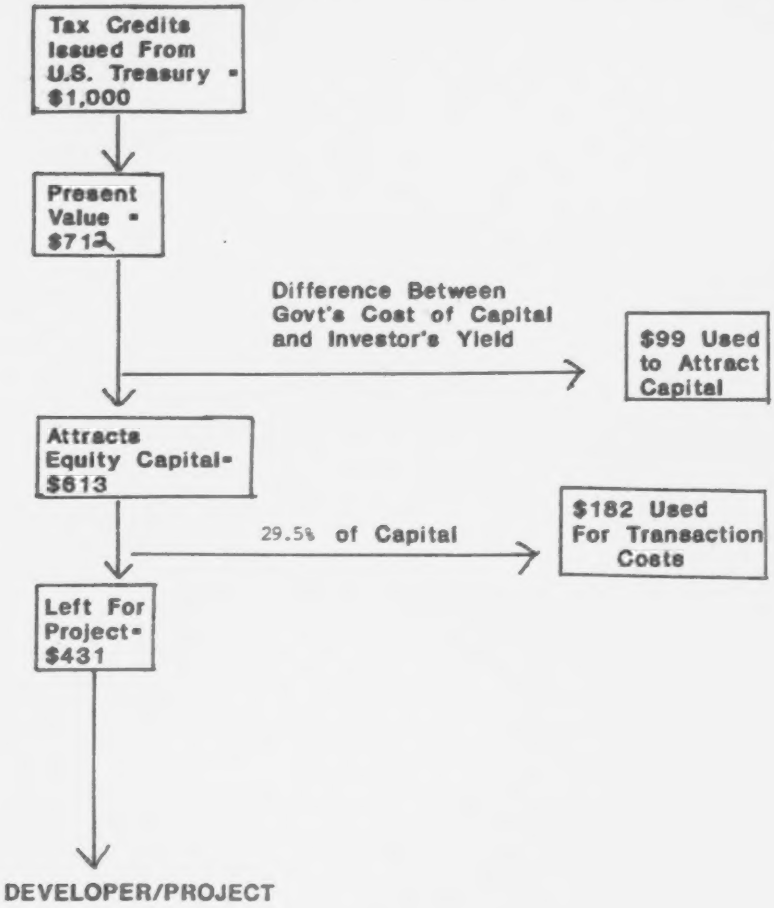
Agency	Authority	Percent used	Credit units
North Dakota	850,000	0.20	9
Ohio	13,440,000	16.95	2,146
Oklahoma	4,130,000	54.88	1,033
Oregon	3,370,000	9.90	310
Pennsylvania	14,860,000	8.90	1,145
Puerto Rico	4,090,000	0.00	0
Rhode Island	1,220,000	0.00	0
South Carolina	4,220,000	16.38	477
South Dakota	890,000	20.81	144
Tennessee	6,000,000	15.25	758
Texas	20,850,000	14.25	2,575
Utah	2,080,000	25.09	400
Vermont	680,000	15.13	97
Virgin Islands	140,000	0.00	0
Virginia	7,230,000	9.80	712
Washington	5,580,000	14.59	365
West Virginia	2,400,000	26.77	436
Wisconsin	5,980,000	21.09	592
Wyoming	630,000	2.24	74
Total	$313,113,750	20.08	34,491

* Ill-Chicago DOH $7,600,000 not
included in state total authority

Source : National Council of State Housing Agencies /
Urban Institute Low-Income Housing Tax Credit Survey

ATTACHMENT V ATTACHMENT V

Tax Credit Project Syndication Funds Flow Chart


Tax Credits Issued From U.S. Treasury = $1,000
Present Value = $712
Difference Between Govt's Cost of Capital and Investor's Yield
$99 Used to Attract Capital
Attracts Equity Capital= $613
29.5% of Capital
$182 Used For Transaction Costs
Left For Project= $431
DEVELOPER/PROJECT

Senator **Graham**. Thank you very much, Mr. Ols. I am going to repeat what I said earlier.

When we move into the roundtable discussion, I would like to open by asking those participants who care to do so to comment on the report that you have just issued and also to encourage some of the questions that they would like to ask of you, which is to say, you are getting the amateurs first and the professionals will come later.

Mr. Ols, you stated in your conclusion that this low-income housing tax credit now represents the Nation's primary effort to encourage low-income housing production.

What is the annual cost to the Treasury of the tax benefits that are accorded under this program?

Mr. **Fricke**. That, Senator Graham, we don't have a figure for this morning. To say it is a complex compilation would be an understatement. We have the figures in our statement of the amount of awards that were given by the states for the projects, but as far as how that costs out, the total credit allocation that we have is $565 million for the years 1987–89. That is just for each year. So that would have to be times a factor of 10, which would give you roughly $5.7 billion. But my understanding is that that is not really the actual cost to the Treasury. It would be something substantially less, than $5.7 billion.

Senator **Graham**. The figure that you started with, $570 million, was that cumulative for those 3 years, or each of them?

Mr. **Fricke**. That is a cumulative figure for the 3 years.

Senator **Graham**. At the beginning of your statement, Mr. Ols, you state "Tax credits are intended to induce investors to supply equity for low-income housing."

Do you have any comment as to how effective you believe they have been for that purpose?

Mr. **Ols**. Well, I think, by looking at what has been allocated, and we talk about 236,000 units brought on line or at least given allocations during those 3-year periods, I would say as long as there have been no abuses, and I have been up here before you, Mr. Chairman, to talk about the Mod Rehab and some of the abuses there that we felt the tax credit money went right into the developers' pockets, we cannot say that for all the other projects that are in this listing where states gave out credits. So if you say that maybe there were no abuses and there probably wasn't, then, in fact, then it has had a benefit of bringing those units on line to meet that demand that we have coming up in the Nation and will only get worse as people repay the section 8 mortgages that are outstanding and take those off the inventory list.

So in that sense, I would look at it as a positive benefit.

Senator **Graham**. There is another objective of this program, and that is, in addition to inducing an increase in the supply of housing that is affordable to low income families, to pass through to those low-income families the maximum benefit of that tax credit. That is to say, if basic housing in a particular community cost $50 a square foot to construct, and if in the open market that price of construction would elicit a monthly rental of a unit of 600 or 700 square feet of $800, and if through this program we are trying to reduce that to $600, in order to make it more available—and you can pick whatever hypothetical numbers you want—has there been any analysis of how effective this program has been in accomplishing that second objective? That is, to reduce to a level below what the market would have otherwise indicated the cost of housing for moderate-income families?

Mr. **Fricke**. Sir, we have not looked at it, other than those eight projects that we testified to earlier. Clearly, in those eight projects, it did not reduce the rents at all. In fact, the rents were established pretty much at the fair market levels. As we, in our earlier testimony, pointed out, it really was a very inefficient combination of tax credits with Mod Rehab. Our final report is probably going to show something on the order of about 80 percent more units in those eight projects—or 80 percent more families in those eight communities could have been helped through vouchers and certificates instead of using the combination of Mod Rehab and tax credits.

Senator **Graham**. If the ultimate rents charged in those low-income tax credit-assisted units were the same as would have been charged in the open market, then can we conclude that there was no inducement by this program? That is to say, if the open market was sufficiently rewarding to cause people to make an investment in housing, then the assumption would be that this additional benefit may have been economically advantageous to the developer or syndicator but didn't accomplish the intended purpose of inducing investors to do something that they would not otherwise have been willing to do.

Mr. **Fricke**. Exactly, Senator. I think, again in the last hearing, the one back in February, with the developer that testified at that hearing, the deal apparently was already pretty much thought through and the mod rehab subsidy in and of itself was sufficient to bring the project on line. Tax credits became an add on, almost an afterthought, is the way it was presented.

Senator **Graham**. We are looking at a limited pool of projects, because all of these are ones where you had Mod Rehab, and generally, if not always, section 8, and then tax credits on top of that.

Have you looked at other projects that didn't have that combination, where the low-income tax credits were the only or the primary inducement?

Mr. **Fricke**. No, we have not.

Mr. **Ols**. I might add one thing to what Mr. Fricke said. I think where you are going is, did we, in fact, by using tax credits, actually lower the rent for low-income housing families to be able to have a more viable—in other words, so we were not costing too much, we were at the 30 percent level or whatever level that might be.

I don't think, in my understanding of the tax law, and I know you have some IRS officials coming up to the table and other officials as well, my understanding is that I don't believe that the tax credits were necessarily anywhere written in the law that would have an effect of reducing the rent paid per family per unit. It was to get the units built and get them on line.

At least that is what I understand. And that is a policy call, whether we want to rechange that to get it down to where we want some benefit given to the individual.

Senator **Graham**. This is a question that I would like some response from the other participants when we move into the roundtable.

The premise is that the unsubsidized free market will not provide this type of housing, and, therefore, some Government intervention or assistance is necessary. The corollary of that assumption is that the definition of this market is people who have limited ability to pay for housing. That is, if there is nobody in a particular community that is providing housing at a monthly rental of let's say $500 or less per month, by this tax credit we will help to create some housing that can be readily available for people at $500 or less per month.

If, however, the conclusion that you have reached in these eight projects, which is that, in fact, the rent that was being charged here was the rent that was being paid in the open market, that is, the unsubsidized market, I come back to the question of, have we accomplished any defensible purpose, or would we not have achieved just as much housing without having to provide this tax incentive?

Mr. **Ols**. In the Mod Rehab we looked at, this is exactly how the scenario played out. Where these other projects that weren't involved, which we haven't analyzed, I really can't speak to.

Senator **Graham**. I would like to discuss with you at some point, maybe after this hearing, what would be entailed in extending the survey that you have done to a broader set of low-income tax-assisted housing to see what the economic consequences are in those.

Mr. **Ols**. We would be glad to help.

Senator **Graham**. Connie.

Senator **Mack**. I may have gotten lost in the numbers as you were working through it, and I don't want to go back and readdress that. What I think I would like to do is just ask you in your own words to tell me what the purpose of your report, your investigation was, and again, just kind of in your own words, what did you generally find out. I am trying to sift it down into something that——

Mr. **Ols**. Well, as we were asked by the committee, we were to tell how much was given out in tax credits, how much money was allocated by each of the States, which we have included in tables in the back of my statement, in those 3 years, which were the 3 years in the tax credits. And we saw a steady increase. And that is basically what we are saying about those 3 years. Just dollar figures, without going behind those figures and finding any more details. Then again, permeated from the start on the Mod Rehab where tax credits were involved in those projects, to go on from that point then to explain the tax syndication process and how it actually flows down, which is what we tried to do in the chart [see attachment V] and then to find out what is being—as the tax credits are used, how much is going off into other endeavors that actually don't arrive at the project level, if you will.

I think that is how I would characterize it. In other words, we go down to through $700 and some dollars, a $1000 in tax credits, and we get down to only X number of dollars is actually going into the project. Other people along the way are getting payment for services rendered, profits, whatever, and not necessarily in an abusive manner, but that is just how the syndication process works.

Senator **Mack**. Just let me stop your there for a second.

Are those costs related only to the fact that the tax-exempt or tax credits were used, or is that cost that would have been involved in the project without tax credits?

Mr. **Ols**. They wouldn't have been involved in other projects, but on the other hand, there are probably other costs that may offset those a little bit. In other words, you wouldn't just have a sheer 1 for 1 ratio of saying, well, if it's in here, it wouldn't be over there. That's not true even under a direct program. You can have certain costs involved to market and get the project ready and get approvals and administrative costs are going on. So I don't want to leave the impression that you could just do away with that and save all that money. I don't think that's true. And Dennis, you might—if that's not exactly right, you might add to that.

Mr. **Fricke**. Senator Mack, as Mr. Ols said, that 26.5 percent or so that we are reflecting as syndication costs, some of those costs, with respect to acquiring the property, title searches, things like this, would be done regardless. There are other fees that are unique to the syndication process. We have not attempted to break those out. But clearly, there would be costs associated in bringing a project on line outside of this particular mechanism.

Senator **Mack**. So the 26 percent is not going to be saved by moving to some other form of financing.

Mr. **Ols**. That is exactly right. Some portion of that, maybe it would be 10 percent or 13 percent—we haven't done that analysis to compare a nonproject with a project to see what that would play out. And you could use past history of direct loan programs in finding out what those costs are in subsidizing and make a comparison trying to see how that would play out in the final analysis. But that is something we have not done at this time. It might be an offer we could make.

Senator **Mack**. Go ahead. I stopped you.

Mr. **Ols**. But basically, what we are saying is that you have costs that are in other directions before you get down to the bottom figure of the project. Basically, what we came away with after we analyzed all that, we basically are saying we think something has to be done at the back end to assure—even if these are all done in accordance with the rules, regulations and tax code or HUD rules or any other operation of State housing, that somebody is charged with the responsibility to oversee that it continues to be used for the intended purpose of low-income housing. I think that is what we culled out of this, and if we didn't get hung up in the financial transactions, but mainly looked at what we were trying to accomplish in the bottom line. And that is something that I think that is a void right now in the program, that nobody is watching to make sure whether it is IRS' role, or the state housing agency role, or it's HUD.

We feel the State housing agency authority seems to be the focal point that ought to work it. Who you get assistance from will be the big question. If it is a violation of tax law, naturally it goes up to the IRS, but I think the States would have to help to show what is going on.

So there's a lot of players that I think could come in and share the burden of oversight, and that is really what I see in this statement and the results of the work we did over the last several months.

Senator **Mack**. Did you conclude or did you attempt to conclude whether this was a program that should be continued?

Mr. **Ols**. No, we did not.

Senator **Mack**. As you were working on this, I mean, being an inquisitive individual, I am sure you must have asked yourself that question: What did you conclude?

Mr. **Ols**. I think that, in fact, as I said in the statement, it is the primary vehicle that we have out there to meet that demand, and in that regard, I would say, as long as the controls are put in place, and we have started that with the laws that were passed last year of requiring certain responsibilities that weren't there by the State housing agencies in the funding part of allocation and looking at all the programs that are subsidizing a particular project or projects. We started it that way. We needed something at the back end. As long as we do that, then I think we should be looking at a viable operation to meet a housing demand issue.

Mr. **Fricke**. Senator Mack, if I could just add to what Mr. Ols has said, I don't think any program, tax credits or any other type of program for the construction of housing really should be used unless it is in a tight housing market. I think—you know, we can generate further conversation about that maybe this morning. But I think that is the premise you initially start with, Senator, that there is a need for additional housing units. Given that condition, then I think whether tax credits or some other form of assistance to stimulate that building is most efficient. That is something that, as John just said, we really haven't studied. I think it would make for a very interesting study. But really, as long as there is a need for housing, and right now tax credits is meeting, to some extent that need in tight markets.

Senator **Mack**. That would indicate to me that there would be certain areas of the country where you would want to allocate those credits and other areas where you would not.

Mr. **Fricke**. I would agree.

Senator **Mack**. Tell me, is there anything in present law that directs that kind of allocation?

Mr. **Fricke**. No, there isn't. I think in terms of, again, markets that I might say would not be ones where I would put in a program such as tax credits, would probably be markets where—I use as an example—perhaps, the vacancy rate is 5 percent or greater in units that rent at or below the fair market rent. If that type of situation exists, I think the existing housing market meets the demand. In situations like those eight projects that we testified on earlier, to have vouchers and certificates available can mean you can serve upwards in those particular examples, 80 percent more people through vouchers and certificates than you do when you combine programs like tax credits and mod hab.

For instance, programs in those markets brought units on line that rented for more than units in the private market.

Mr. **Ols**. Senator Mack, I believe, and I would have to research it—I think the 1989 law, I think it allows a reallocation of credits that are not needed or not used in certain places. I believe that is a provision, if I remember from what I've read. That would be one thing that might help to move that around a little bit. So you can move it to where you really need it, but there ought to be a determination, as Mr. Fricke said, we really should be giving them all to start with, but it is an assumption. But I know the law did allow that movement of tax credits.

Senator **Mack**. Did the 1989 law do anything with respect to monitoring? In discussions with folks at the State level, certainly, I seem to recall that the issue of monitoring was raised. I am curious. Does the 1989 law provide any further direction with respect to monitoring?

Mr. **Ols**. I don't believe it does. I would have to recheck, but I don't believe it does. It does talk about it up front and what they are suppose to allocate and monitor the allocation process, but I don't believe it does on the back end.

Senator **Mack**. All right. I really don't have any further questions at this point.

Senator **Graham**. Just a short set of questions. One to follow up on what Senator Mack was just asking about. And this is a question that I would like to get some comments from the other participants when we go to the roundtable.

What you said is that the character of the Federal subsidy should be a reflection of whether that particular community is supply-deficient, i.e., needs more housing to be available at below the market rate or is demand sufficient, in the sense that you need more resources for potential families who will occupy those units, or what is the supply and demand in the particular community?

Would that suggest that, rather than the current categorical approach that we have where tax credits are put in one box, section 8 is put in another box, and what is available for other forms of supply production in additional boxes, some form of combining all those and then allocating them to communities based on economic factors, such as the amount of capacity available at below market rate rents to respond to the individual needs of that community would be preferable?

Mr. **Ols**. Well, I guess, you know, as a policy call you could put it that way. You could make it one whole package which might make it more clear and less confusing. The more subsidies that are brought to bear through several programs, whether it be tax or Mod Rehab or rental assistance or anything, is going to make it more involved, and I guess that would just be something from a policy point of view. Whether that would be a cleaner way or it would be more clear to understand and make sure you know where everything's coming from. But I think the 1989 law, by assigning the States responsibility to analyze what all those allocations are, and I know you have a gentleman on the panel coming up to discuss what they are doing, I know that, in fact, they are having difficulty—how are we going to know all the values and benefits of all these other programs that are coming into play, and maybe that would further that discussion as far as whether or not we should put it all in one window rather than several windows.

Senator **Graham**. Last question. Another aspect of this I am interested in here is, who are the families that get the benefit of this program? In most communities, there is a substantial waiting list maintained by public housing authorities of people desiring to get into subsidized housing. In the eight projects you looked at, how were the people who actually got the benefit of living in these tax-subsidized units selected?

Mr. **Fricke**. Senator Graham, for the eight projects there was a requirement of the Mod Rehab Program that those people would be taken from the public housing waiting list. It is not a requirement for tax credit projects that would be built without any additional subsidy, and for good economic reasons. Some of these people on the waiting list have median incomes of 20 or 30 percent and, frankly, I don't believe the tax credit subsidy, unless it were in very unusual circumstances, would be able to reach down to those types of people.

Again, with the eight projects, you had the section 8 mod rehab, in conjunction with the tax credits, which basically just supplemented their rent payments. So it did make it economically workable.

Senator **Graham**. Again, I think we are working here with eight projects that have the distinguishing characteristic of all being Mod Rehab, which makes them unique or special in the universe of all low-income tax credit-assisted housing. Again, when we have our roundtable, I would like to pursue what are some of the characteristics of the families who occupy the full range of low-income tax-assisted housing.

Thank you very much, Mr. Ols, and Mr. Fricke. Mr. Fricke, I am sorry that I mistook you as being Mr. Weicher. You certainly make a very significant contribution.

If the members of the panel would please take their seats.

Ladies and gentlemen. As I indicated earlier, I would like to start with any comments that you might have on what we have just heard from GAO. We have tried to structure the roundtable around a series of five questions. The specific responses that most relate to the GAO report are focused on question 2 of that list, which is:

How can the net capital invested in credit-assisted low-income housing be maximized, or are there alternative, feasible means of inducing investment in low-income housing that are more likely than the tax credit, as it is currently structured, to produce more housing units or an equal number of housing units at a lower cost?

Comments on the GAO report?

Mr. **Haynsworth**. Yes.

Senator **Graham**. Mr. Haynsworth? As you respond for the first time, if you could give us your name and your affiliation and up two sentences of Yellow Page advertising. [Laughter.]

WILLIAM E. HAYNSWORTH, SENIOR VICE PRESIDENT, THE BOSTON FINANCIAL GROUP INC., BOSTON, MA

Mr. **Haynsworth**. I don't know about the advertising. But I am Bill Haynsworth, senior vice president of The Boston Financial Group. And we have—I guess this is two pages of advertising. We have raised $290 million in the public equity marketplace for low-income housing tax credit projects.

I will say I thought it was a very good balanced presentation. One fact that I want to clarify a little bit, and that is that the current market in the public fund area is that the project will receive approximately 50 cents as opposed to 41 or 42 cents—I have forgotten the exact amount—on a net basis of capital. In other words, the transaction costs amount to around 21.2 cents and the projects get about 50 cents. That is the experience with, I think, the major players in the area.

BARTON HARVEY III, DEPUTY CHAIRMAN, THE ENTERPRISE FOUNDATION, COLUMBIA, MD

Mr. **Harvey**. I am Bart Harvey, deputy chairman of The Enterprise Foundation, which is a nonprofit foundation also engaged in using the low-income housing tax credit. We have raised about $118 million primarily from corporations that we put back into this tax credit in partnerships.

I would just like to ask Mr. Ols, what percent of the total tax credits that were used went into Mod Rehab? Is it not a very small percent of the total?

Mr. **Ols**. I wish I had an answer for you. I asked Dennis that this morning, because I was afraid that might come up, but we don't have that. Maybe someone from HUD might have the figure. I don't have that, but I think it is small, but I don't know the figures.

JOHN WEICHER, ASSISTANT SECRETARY FOR POLICY DEVELOPMENT AND RESEARCH, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, WASHINGTON, DC, ACCOMPANIED BY FRED EGGERS, ASSOCIATE DEPUTY ASSISTANT SECRETARY FOR ECONOMIC AFFAIRS

Mr. **Weicher**. Mr. Chairman, I can respond to that, if you would like. John Weicher, Assistant Secretary for Policy Development and Research, HUD.

In the work which we have done in our own monitoring of the tax credit, we find that there were about 12,000 Mod Rehab units or about 8 percent of the total in 1987 and 1988.

Mr. **Harvey**. And the follow up to that question is: in considering the whole tax credit program, in this particular committee we are really looking at just 8 percent of the whole, and the use of tax credits with mod rehab is an unusual slice of the whole tax credit picture. In other cases, at least that we have seen, the tax credits needed other subsidies, with the exception of the Mod Rehab Program and maybe pieces of other programs.

Mr. **Ols**. I would agree with Mr. Harvey. There is no question. And that is why we haven't looked at some of these other projects other than the Mod Rehab, because that was where our focus was and our objectives. The example on the flow chart [see attachment V] that we discussed earlier does not include the Mod Rehab program. That is a normal flow you would see happen. That surely didn't happen in those Mod Rehab projects. So I would agree.

Ms. **Reaman**. Mr. Chairman?

Senator **Graham**. Yes.

Ms. **Reaman**. My name is Susan Reaman. I am with the Office of Chief Counsel of the Internal Revenue Service. I would just like to clarify two points with regard to the Act under section 42 itself, of the Internal Revenue Code.

To qualify for the credit, the low-income units must be rent-restricted, and that means that an owner cannot charge more than 30 percent of either 50 or 60 percent of the area median gross income adjusted for family size. Also, as far as monitoring compliance under the Omnibus Reconciliation Act of 1989, the state housing agencies must report to the Internal Revenue Service any noncompliance that they have discovered over the compliance period.

Senator **Graham**. Who is required to report?

Ms. **Reaman**. The State housing agencies which allocate the credit.

MARK HENDRICKSON, EXECUTIVE DIRECTOR, FLORIDA HOUSING FINANCE AGENCY, TALLAHASSEE, FL [REPRESENTING THE NATIONAL COUNCIL OF STATE HOUSING AGENCIES]

Mr. **Hendrickson**. I am Mark Hendrickson. I am Executive Director of the Florida Housing Finance Agency and am here representing the National Council of State Housing Agencies. The exact language in the law as it relates to monitoring is "a procedure that the agency"—meaning the State agency—"will follow in notifying the Internal Revenue of noncompliance with the provisions of this section which such agency becomes aware of."

So when we get to the question on monitoring, we can go into more detail, but it does require us to notify what we become aware of, but it does not require us to proactively seek out noncompliance through an active monitoring system, on which I will have some comments later on.

Also one other question to follow up on. The rent restriction just came out in some of your questions to Mr. Ols. There are rent restrictions on all tax credit units. For example, I have a compliance manual here and in the Fort Myers area, a two-bedroom unit is limited to $38,000 including utilities, as one example. But that is not necessarily rent that will be affordable to the very lowest of low income people at 10 or 20 percent of median, but it is a rent restriction.

One of the questions that I think as an allocating agency we are going to have to think about when we decide how much credit does the project need is, if a project comes in with rent substantially below the limits that are allowed by the Federal law, they will then need additional credits in order to support that additional subsidy. So we have a situation where when we have two identical projects, one of them proposing to charge lower rents to serve lower-income people and therefore needing an additional allocation of credit for the same physical unit being produced.

Mr. **Weicher**. Mr. Chairman, if I may comment on the rent restriction. The limit is that the rent may be no more than 30 percent of 60 percent of the area's median income. This will be above, typically, the amount that is permitted under our voucher and certificate programs, the fair market rents, which we set for vouchers and certificates. So that typically, the voucher certificate, with rare exceptions—there are a few places in which the fair market rent would be above this—there is essentially a rent restriction here. This is restricted to relatively low-income people, and for those who are really low income, there is the possibility that a tenant can bring a voucher or certificate. If they wanted to choose to live in this project, they can do that, but then it becomes the option of the very low-income tenant, and this project must compete with whatever else is available to them in the local private market.

Senator **GRAHAM**. Would you repeat that?

Mr. **WEICHER**. It is 30 percent of 60 percent of the median income. If the median income—nationally, the median income is a bit more than $30,000. That would say, 60 percent of the median would be about $18,000. Thirty percent of that would be $5,400, or $450 a month would be the rent maximum. And the rent can be no more than that for—I think that would be a two-bedroom unit in that situation.

Now that will vary, of course, with the local median. It will be higher in some places and lower in others.

DAVID BLATTNER, ASSISTANT COMMISSIONER FOR EXAMINATION, INTERNAL REVENUE SERVICE, WASHINGTON, DC, ACCOMPANIED BY SUSAN REAMAN, ASSISTANT BRANCH CHIEF, CHIEF COUNSEL'S OFFICE

Mr. **BLATTNER**. Mr. Chairman, I would like to clarify one other point.

I am David Blattner, Assistant Commissioner for Examination, Internal Revenue Service.

The provisions of the Internal Revenue code require annual certification with the filing of IRS form 8609, which requires, under penalty of perjury, that the owner of the building shall certify continued compliance with the low-income provisions. I think that is one other means that we use to ensure that the building continues to meet the requirements established by the provisions of the code.

Senator **MACK**. Let me just ask a follow up to that. Are you saying in that there is a requirement for those who use tax credits to file annually their compliance with the rent restrictions? And who does that go to?

Mr. **BLATTNER**. Form 8609 has to be filed annually, certifying continued compliance with the low-income housing provisions. That is attached to the tax return. If, in fact, a credit has been claimed and that annual certification is not part of the return, we then correspond with the owner of the building asking for that certification. If, in fact, the certification does not come back to us, we disallow that year's credit, plus we look at prior years as to the possible recapture provisions.

So there is an annual certification required by the owner under penalties of perjury.

Senator **GRAHAM**. Are there any other comments on the GAO report?

Mr. **FRICKE**. Senator Graham, one thing I would just like to add just for clarification. Renters, almost by definition, might be classified as being low-income. Back in 1986, GAO issued a report that pointed out that the average income of a renter is somewhere between 50 to 60 percent of median to begin with. So when we talk about providing low income housing for low-income people at about 50 percent of the median income, we are really talking about providing generally rental housing for the population that on average, would be requiring it anyhow.

So we are not comparing these low-income people to some of the residents, for example in public housing, where median income tends to be 20 or 30 percent of median income. Just as a point of clarification.

Senator **Graham**. Staying with the question which was number 2 or number B on our listing, do you have any recommendations as to alternatives to the current low-income family tax credit as a means of providing low cost units or units that would be less costly to the eventual using family than the current system at the same cost to the Federal Treasury?

Mr. **Weicher**. Mr. Chairman——

Senator **Graham**. I guess the question is, is this an optimally efficient program for its intended purpose?

Mr. **Weicher**. We think it is a good program, Mr. Chairman. We think it serve the needs of States and localities in providing housing where additional housing is needed or rehabilitated housing is needed. I think it was Senator Mack who raised the question of how much of the various cost items in that other chart were unique to the tax credit. And I think apart from syndication, the answer would be, they are not unique. It has traditionally been expensive to build housing directly for poor people. There are a number of studies which have been done by HUD and others over the years, which trace out cost components which really don't translate into improved housing and they are typically quite substantial. We have not done a blow-by-blow comparison of these to—the tax credits to some of the earlier programs. But it does not look to us as if the tax credit is particularly an expensive vehicle. This looks like a reasonable one at this point, subject to some further investigation.

So I think your point is well-taken, Senator. The provision of new housing through any of the subsidy programs in the past has been a very expensive process and, in fact, every few years Congress has concluded this to be the case in a new generation of construction programs and has terminated those programs and tried again. We can trace at least three generations of construction programs, expensive ones, over 25 years.

Mr. **Hendrickson**. Mr. Chairman, following on that point, I think that any raising of capital for low-income housing has those inherent costs, and from my viewpoint, I don't think that this is a particularly costly one compared to other programs. But two things to add. This is becoming increasingly a syndication market. When this program began, there was no one out there that syndicated tax credits. There was very little competition, very few firms. A few got into it.

At this point, I think that efficiency will be improved because there are a lot of firms that are actively seeking projects in the syndication market which creates a competitive environment. I think that within a really better analysis of this whole system might be made a year or two out from now as the myriad of firms syndicate and compete with one another to see what the net dollar cost of the project is, due to that competition.

One of the things that adds to that is that there are nonprofit syndicators which I think add significant pressure to be as efficient as possible, and they have been very successful. There are also public agencies, not including ours at this point, but other State housing agencies which are getting into the syndication business, again, with the idea of having the maximum dollars delivered from the investor to the project.

In our case, one of the things that we do to encourage that competition is that we put together a tax credit syndication handbook that we give to everyone that applies for tax credits that lists out every syndicator that we have with the basic procedures to encourage the developer to shop for more syndicators to get the best deal that they can. So I think that competition will marginally increase efficiency over the next few years also.

Senator MACK. I am still trying to focus on, again, the effectiveness of the program or determine the value of the program. I sense from the comments that you made, Mr. Weicher, that the tax credit program provides housing units for low-income, but in the upper range of low income.

Is that right? Does this really focus attention to just one area of the low-income problem that we are dealing with?

Mr. WEICHER. The limits carry us to, as we are saying, people, above the eligibility limits typically for the standard subsidy programs, the voucher and certificate and public housing. And without further subsidy, those are the people you are likely to reach. But it is possible to combine this with a voucher or certificate, if a person wants to live in one of these projects. The voucher or certificate can be used to afford the project. But we don't have full information on this, but as they are designed, they would not reach down to the very bottom of the income distribution without further assistance.

Mr. HARVEY. May I add to that?

Senator MACK. Sure.

Mr. HARVEY. Our whole purpose as a nonprofit foundation is to get to very poor people, and one of the things that we particularly like about the tax credit program is that it is so targeted and in essence goes to people at either 60 percent or 50 percent of median income, and you start there. The credit is unlike the other tax advantages that existed before that were spread over an entire project that may have a certain percentage of low income in it as well as moderate and upper income units in it. These tax credits only go to those units which serve those people at 60 percent of median income or below. Additionally, they did something else which we very much like, which is to adjust for family size. In essence, to take into account the number of people that were going to live in the units. If it is only one person, you are way down below 60 percent income, as far as who you are serving.

So this program is very highly targeted, and it only goes to the families that you really want to serve. The way that we use it as we have used it in New York, is for 235 of 912 units to serve homeless people. To do that, you need additional subsidies that homeless people can get, but we end up saving the city a tremendous amount of money in using this program and one of their subsidies, rather than a welfare hotel, for instance.

So from our point of view, we like who it serves, and unlike some other subsidies that may come directly, with all due deference to people around this panel, some of them go to moderate income people, as well. I mean it goes over the whole range.

Senator MACK. Following on to a question that Senator Graham raised earlier, does this really increase the dollars available for new construction? Is it an effective program for new construction? I think you were raising earlier whether there is the proper tradeoff here for the credit that is given.

Senator GRAHAM. Just to restate. The question is, What degree of change in economic activity does this tax credit create? How many of these units would not have been built but for this tax credit?

Mr. HENDRICKSON. Mr. Chairman, I think that there's two answers to that question. Pre your 1989 reforms and post. That clearly under the old laws that there were units that could have been produced anyway and served essentially the same group. But with the credit underwriting and the need for the credit that is in place now, I don't think you are going to find any units that would have been built and rented to very low income persons.

Under the tax credit program from now on, I think you are going to be close to 100 percent of the units being produced as a result of the credit. Now there may be developers who would have built the units, but they would not have rented those units to people in this income group. So in terms of developing housing for this income group under the new law, I think that it is a tremendous inducement and the housing would not be produced for this group otherwise. And if it would be, we won't give them a credit. I mean, our credit underwriting will be such that if we look at the project, and it is financially feasible without a tax credit, they won't get one.

So the projects that would and could be built without the tax credit subsidy won't be given a tax credit subsidy.

Senator MACK. For those of you who, I guess, are involved in either development or syndication, do most states take the attitude that was expressed by Mr. Hendrickson?

Mr. HAYNSWORTH. Well, actually, under law, they have to take that attitude right now, because they are charged with the responsibility of giving no more credit out than is necessary to make the project feasible. That is the part of the 1989 act. So they all have to do that.

In the past, actually I think that a fairly overwhelming majority of the units even prior to the 1989 act would not have been built without the credit, because—and prior to 1986, units were being built by private industry because of the structure of the Tax Code at that time, but when you took away passive loses, the ability to use passive losses and that sort of thing, we haven't seen—for example, there is no real conventional syndication market, private equity, capital raising market at all. At this point in time, there hasn't been for some point in time, and I don't see it in the foreseeable future right now.

And I think that what we have seen, except for some of these mod rehab transactions, that credit has been necessary to make projects work. Now I'm not—I think that the improvement in the

1989 act was to charge the states with the responsibility of really looking to see that credits weren't overallocated, because it might have been overallocated.

In other words, they were necessary up to a certain amount, but maybe more was granted than was absolutely necessary. I think Florida was the first State that we saw that really looked at development fees, for example, and limited development fees, to Florida's credit.

Mr. **Harvey**. I would concur with Mr. Haynsworth and Mr. Hendrickson, in that there is a real, vital change in the way the tax credits are being administered as a result of the 1989 changes in this law, and it really is getting at a lot of the questions that are on this list. The changes make sure that the projects are underwritten properly and make sure that nothing more is given than is absolutely necessary to build the unit. I think they would have cured the combination of Mod Rehab and tax credits had they been in place. Speaking on behalf of low-income people, the extended use part was another very important product, saying that the Government was going to get absolute maximum use for low-income people out of these units for as long as it is conceivable for putting up this money and getting these units developed.

So all of those are very critical changes in making this the best program it could be.

Senator **Graham**. Mr. Ols at the conclusion of his testimony had indicated some additional questions and possibly some areas for further legislative consideration.

Mr. Ols, would you like to briefly summarize those and then I would like to solicit comments.

It looks like we may be about ready to have another vote.

Mr. **Ols**. Yes. We laid out a couple, and one is, you know—and I think we addressed a couple of those as we talked this morning, you know, can transaction costs be reduced, and can we still get the syndicators willing to come in and work with us and work with the Government and the States.

Another one, whether or not corporations should get both benefits and tax subsidies and the passive credits as individuals can't get all that. Will that have a detrimental effect, again, keeping the same idea in mind which you asked, do we need that to make sure we keep building low- income housing?

And then, whether or not other financing alternatives are available, which is similar to one of the questions you have on your agenda for the panel.

Those are the three issues that we sort of raised that need more exploratory discussions from people that are involved in these transaction much more than our office is.

Senator **Graham**. Any further comment on those questions raised by Mr. Ols?

Mr. **Harvey**. Well, on one of them, on the corporate market. The corporate market does get both passive losses and tax credits, and we raise only corporate money, and we put it back into low-income housing. And it is priced, based upon the tax break that corporations are getting on those passive losses. We have in our calculations never calculated any residual value, because we always wanted the housing to continue as low income. The corporations never bought tax credits from us on that basis. And we sell tax credits to them less as a real estate transaction than as a tax-driven transaction that also does public good. Therefore, it is a pricing mechanism. If you take out the passive losses to them, you will not get as many dollars per each tax credit that you put up.

Mr. **Haynsworth**. If I could add to that also. We have done some selling to corporations as well, and corporations really demand more in the way of return than individual investors do. So you really do need that passive loss—we feel you need that passive loss benefit for corporations really to induce them to be in the business.

Also, those passive losses ultimately there is a repayment when the property is sold or disposed of.

On the question of syndication costs and that sort of thing, I think that competition will ultimately be the determinant of what those costs are, and I think costs have come down somewhat as competition has increased. So I think the point made by the gentleman from Florida was a good one.

I think we are going to the individual investing marketplace instead of directly to corporations. You are going to find your costs of raising capital are not that elastic, if that is the correct word. You still have to pay Wall Street brokerage a commission to sell. We are talking about investors who really are investing from $10,000 to $15,000 in average. We are not talking about large-scale investors they used to have in the syndication business.

So you have a lot of investors that you have to attract to make this program work. So basically, you have the cost of SEC clearance, blue sky and that sort of thing. So those costs are really there. So I think it will come down some, but I doubt if there is a lot of room for them to come down substantially.

Senator **Graham**. Ladies and gentleman, Senator Mack and I are going to have to leave to make a vote. We will return as quickly as possible. I think we have covered most of the issues under question No. 2. I would like to briefly go to question No. 1, which is: What data are now available or do you think should be collected relative to the use of low-income tax credits? Then, we will return to question No. 3, which will get to some of the issues that were raised earlier, and I think particularly Mr. Hendrickson could discuss, and that is the new responsibility of State housing finance agencies.

Recess for 10 minutes.

[Recess.]

Senator **Graham**. I will call the meeting back to order.

We are going to endeavor to complete this hearing at or about 12:30, so to use our time as effectively as possible, I would suggest we go to question 3, which is the issue of how are the State housing agencies and HUD implementing the 1989 changes in the law.

Mr. Logue, would you like to comment on that question from the perspective of HUD?

JAMES LOGUE, DEPUTY ASSISTANT SECRETARY FOR MULTIFAMILY HOUSING, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, WASHINGTON, DC

Mr. **Logue**. Sure. It would be my pleasure.

First, let me say that in both the State agencies and the Department in different parts of different legislation have similar requirements for assuring that. In our case, the Department subsidies and in the States' case, the tax credits are allocated in a fashion where we do not provide more assistance than is necessary to make a project feasible. Ours relate to the subsidies we provide or the other forms of assistance that we provide, whether it is insurance or section 8 or other forms of assistance we may have available for our existing inventory.

In a general statement, I would like to say that it is our intention—and I think we have made some significant strides in working with the individual agencies that allocate the credit, as well as the Council of State Housing Agencies, which is their national organization, in communicating, opening lines of information sharing. We have a tremendous amount of information that we have received from the State agencies through NCSHA, which has been helpful to us in understanding which projects might have involvement from the Department that would also be in line to receive tax credits.

In that instance, I see that as an ongoing process that will hopefully lead to a very clear and coherent process that both the States will understand and the Department will understand in analyzing projects that have multiple subsidies involved with them.

We recently requested all of our field offices to visit with their respective State housing agencies or credit allocation agencies. Those meetings have taken place. So from the field perspective, the field understands where the state agencies are in their allocation process, what it is, in fact, that they are going to be doing under their process has opened up a very significant and focused line of communication between the individual State allocating agencies and our HUD field offices. So it has been a very positive development and, again, we look forward to continuing to work with the State agencies individually and through their national organization.

As you know, under the Reform Act, the Department has a similar requirement in allocating our subsidies to provide no more assistance than is necessary for a project or a transaction, than is necessary to make it feasible. We have been working in developing through the regulatory process under H.R. 1, those various regulations implementing section 102, particularly, which is the section that deals with assistance provided by the Department, and those regulations should be completed and in force by somewhere around July or August of this year.

We have also been collecting through our field offices information on all projects that we have any involvement in with regard to the use, particularly, of low-income housing tax credits with any project that would receive our assistance. And to the extent that projects do receive assistance or multiple types of assistance, particularly the low income housing tax credit, we will be collecting all information relative to the sources and uses of those proceeds, both the tax credit proceeds and the Department's assistance and making valuative judgments as to the appropriateness and the appropriate level of subsidy that we would provide, taking into account the level of assistance that would be coming from the tax credit or other local sources.

Senator **Graham**. Mr. Logue, will that analysis include section 8 and Community Development Block Grants as part of the sources of subsidy?

Mr. **Logue**. Absolutely. It will include essentially any form of assistance that the Department may be providing to a particular project and that would include CDBG, section 8, flexible subsidy. Those would be the major types of funding programs that would be used in conjunction with a project that could use a low-income housing tax credit.

Senator **Graham**. In that, do you make a distinction between those subsidies that are project-based and those that are nonproject-based?

Mr. **Logue**. That is one of the areas we are looking at right now. There would be likely a distinction between, let's say, a tenant-based voucher or certificate used in conjunction with a project that might be somehow financed in part or using a low-income tax credit. But our major focus are the project-based subsidies that would be tied to a project that was using the low-income housing tax credit. There is definitely a distinction between the two. Basically, in a project-based type of——

Senator **Graham**. Is that a legal distinction or an economic distinction?

Mr. **Logue**. I'm not sure if it is a legal distinction. I think it is a practical economic distinction as far as, is there any likelihood that a project or tenant-based subsidy would be used in the economic development of a particular project. And generally speaking, since tenant-based subsidies, by their nature, can move with the tenant, it is very difficult to factor in tenant-based assistance in the economic development of a particular project.

Senator **Graham**. Mr. Hendrickson?

Mr. **Hendrickson**. Mr. Chairman, if you would allow me to describe the process we are using in Florida to make certain that projects will not receive any more tax credits than they need for project feasibility, and I think that the process that we have is repeated in various forms, with essentially the same mechanics in all other States by the State housing finance agencies.

There is really a three-step process, in that in any of the steps, the amount of credit is subject to being reduced to a level of what is needed.

The first process is a scoring process, a competitive process. In our case, it opens up on May 1 and runs for a 1-month period. Developers will submit initial applications for tax credits, and they will be ranked competitively, based upon a scoring system that has various components, but one of the most important of the components in our scoring system—in fact, it amounts to approximately 15 percent of the total points that are available—is the leveraging of the credit. How many bedrooms are produced per credit dollar. And the developer who at this first stage asks for the least amount of credits per bedroom will be given a significant amount of points.

So phase one is that the competitive process will reward those who on the front end just ask for less credits.

Then the ones who win in that competitive scoring process, they move to a second phase, which is a full credit underwriting evaluation. At that stage, we will look at the reasonableness of all of their costs. We will look at the construction budget, we will look at their developer fees, we will look at their whole package and determine if the costs that they claim are reasonable. If they are not reasonable, we will adjust them downwards for the purposes of calculating credit.

We will look at the rents that they are proposing. We will do a standard project pro forma, and we will determine how much credit equity would be needed to make the project feasible, based upon the rents and the income that they will bring and the cost of building or rehabilitating the project.

And again, we will not accept their costs on face value, we will do an independent evaluation of their costs and then we will determine the need.

Then a third stage of this is that once the project is actually placed in service we will look at the actual cost that they have incurred and not just their projected cost and would be able to again do a final credit evaluation based upon the need after we have actual costs in hand.

So there is a three-step process. The first stage weeds out the most inefficient. The second peels apart their—what they claim their costs are and looks behind them for reasonableness, and then the third stage will actually look at what it actually costs them to build and make a final credit allocation.

I am convinced with that process that we will have a very efficient use of the credit within the various locations in Florida, and I think that this process will be used across the country by other state agencies.

Senator GRAHAM. Any other comments on the questions of the relationship between HUD and the State agencies?

Yes, Mr. Harvey?

Mr. HARVEY. Yes, Mr. Chairman. I think in scientific law no reaction can have any greater energy than the action. In the 1989 tax changes, the reaction may be greater than the action originally taken. Our concern is—we are working with nonprofit groups that have to use a number of different subsidies with this tax credit, and therefore, they are going to different areas to try and get those subsidies together. So they will go to a State agency for the tax credit amount, and then they will go to HUD for some other form of subsidy or program. And it is very important to us and to the efficiency of this program that the State agencies and HUD determine who makes that last allocation decision, because if both of them are trying to figure out whether and what amounts are being awarded by each other, the poor person trying to develop in the middle is left not knowing what amount of subsidy they are going to get from anyone and who the final arbiter is and when that decision will finally come down.

So it is very important that there be some efficiency in who's making those marginal allocation decisions. I guess I'm asking it back to the State agencies and HUD as to how they would work together.

Mr. **Hendrickson**. I think it is an excellent question and I think that we are working to determine that. The last thing that we want is a bouncing back and forth and wasting a lot of time. I guess we will have to come to final agreement, but from our perspective, we will look at the tax credit as the last subsidy. Whatever is there, then we will assume it can stay there and the amount of credit would be reduced if the project would still be feasible. And of course, the key to it will be having to be a quick turnaround in our work with HUD, so we are not taking weeks and weeks to make that determination. But we will approach it as the tax subsidy, as the last subsidy and the one that would be reduced, if the other subsidies, in combination, would allow that to take place.

Mr. **Logue**. Yes, I think the important next step in this entire process is the process we are now finalizing, and that is, what is exactly the analysis we will use, we being the Department, will use in making our resources available to a particular project. I think it is a process issue, and the process needs to be understood by the State allocating agencies and the development community who will be using these variety of sources of funds to make projects work. I think it is an information issue. It is a process issue. It is a clear direction, and in some instances, even a training issue.

As far as what it is that we will be looking at, what are our interests, as I look at it and I think as the Department looks at it, both a low-income housing tax credit, and the subsidies and assistance the Department would provide are all Federal resources. To the extent that one is higher, one is lower, is really the issue. The States allocate and control the tax credit. We allocate and control our subsidies. We want to make sure we are not providing too much. They have an equal interest in making sure that they're not providing too much, which I think it is simply a function of all of us coming together, understanding each other's processes and interests and assuring that collectively we have the final package, we have a project that will work but is not overly subsidized.

Senator **Graham**. I regret that we've got another vote underway. Senator Mack and I chatted and would suggest that our staff, Mr. James Watt, the chief minority counsel, Mr. Sandy D'Alemberte and whoever else would like to participate continue this. We will return as quickly as possible. I just hope that the level of discussion doesn't go up too much. [Laughter.]

Senator **Mack**. Yes, we do take a certain degree of risk here with this.

Mr. **Dinsmore**. Mr. Logue, I think it would be helpful to go back and take a look at this chart here that we have. It is our best effort in defining the major HUD subsidy programs that at least up to now have been used with the tax credit projects. The chart also includes Farmers Home, and we didn't mean to slight Farmers Home in excluding them from our discussion here, if anybody from Farmers Home happens to be here.

But why don't we focus on, first, the CDBG grant money and then go back to section 8 and really talk further about how HUD will approach those two pots of money in implementing its section 102 responsibilities.

Mr. **Logue**. Are you talking about basically tax credits and CDBG funding?

Mr. Dinsmore. Tax credits and section 8 monies.

Mr. **Logue**. Well, essentially, what we will be looking at are three principal areas that—let me start even a little further back. Right now our existing programmatic processes with regard to allocating assistance, and I am not in the area of CDBG, it's not my area specialty, but I think I can generically talk about it.

What we are looking to do is making sure that our existing programmatic rules and regulations for putting out funding work fairly well in assuring that we are not putting out more than is necessary in a transaction, and generally, that is the goal and basic foundation of the way we award assistance. And generally speaking, I think our existing programmatic guidelines assure that we do not provide more assistance than is necessary on a particular project, taking into consideration just the types of assistance that we control.

The area where our controls do not do as good a job and really have not up until relatively recently, taking into account our other forms of assistance that may come into a transaction that our processes do not account for. And the principal area that would be significant is in the low-income tax credit. Generally speaking, for production programs or where we are providing section 8 for a new project, we do not—our processes have not accounted for the proceeds that would come in through the low-income housing tax credit. What we are doing now and will formalize through the development of the regulations under H.R. 1, is capturing all the dollars that come into a transaction which would include not just our assistance but outside assistance and principally the low-income housing tax credit.

We would then assess basically the sources and uses of all the funds that come in, capture all the dollars and assure ourselves that when combining all those dollars that are coming in for a transaction, that the appropriate levels of funding, both from our subsidy and from the tax credit are going to reasonable costs, reasonable expenses associated with the project and not too much is going out in an area that should not otherwise go to the project.

That is the general framework under which we are going to be approaching all of our levels of assistance and is required under section 102.

We would principally be looking, particularly in a tax credit transaction, whether it is with CDBG or section 8, at reducing our assistance to the level we feel is appropriate, based on the sources and uses of the funds, all the funds that would come into a transaction.

So in other words, if we were looking at three principal areas. What is the seller in the transaction taking away from the transaction? What is the developer in a transaction taking away from the transaction? And what is the investor, particularly in the case of low-income housing tax credits, the investor getting from the transaction?

Those are the three principal areas. You also have other third party fees, you know, syndication expenses, attorneys fees, other negotiated costs that we would also be looking at and making sure that the entire package, taking into account all the funds, represents a reasonable, rational project from our perspective. And I think if it is from our perspective, it works, I think, from the State agency's perspective or whoever else is involved in the transaction. That would be the ground work for saying this is a reasonable project, considering all the sources and uses of funds.

Mr. **Dinsmore**. I appreciate that you are working through your regulations, and you may feel that it is premature for us to press you, but CDBG, as I understand it, is largely an entitlement fund for money. Is it the Department's current analysis that the duty that is imposed under section 102, applies to entitlement money?

Mr. **Logue**. I think that the approach we are taking is that if CDBG funding is going to assist a housing project, it would fall under the purview of section 102, and we would have to consider that funding if it is being used in conjunction with other governmental assistance that's not provided by the Department.

Mr. **Dinsmore**. Mark, of course, entitlement money flows down through State and local governments, and they in turn use it for a variety of purposes and have in tax credit projects. What is your perspective on this?

Mr. **Hendrickson**. I guess what I am hearing here disturbs me a little bit. I think we have a problem potentially in this system as Jim is describing it, and I hope we work it out. But generally, the tax credit is going to be the last thing that a developer gets in his long process of putting together a project. He's not going to be getting a CDBG grant after he applies in our tax-credit process. He is going to be out there in the community working to get a CDBG grant up front with anticipation of having his whole package put together to apply for a tax credit allocation. I mean, almost all tax credit competitive processes are geared towards giving the credits to people that have an ability to proceed. "An ability to proceed" means that they control the land, they've got their local government and other subsidies in line, and that they are then coming last into the credit process.

And I think if we have a system where they have gone to the city of Miami, maybe the city of Miami gave them CDBG money to acquire the land for the project. They then come in for tax credits. They can't be in a situation then where HUD intervenes and says, "Well, we have decided that you really can't have that much CDBG money," because we're going to be in this Catch-22 of saying, well, if they have less CDBG, they need more of this, and it can be very unworkable. And as the tax credit is generally the last subsidy, it would seem logical that that is the place to make the decision, given all the other Federal subsidies that are in place and local subsidies, State subsidies, what is the minimum amount of tax credit needed to make the project work.

And one other point, though HUD has not worked out its system, time is of the essence. We are under the gun here to allocate tax credits and to come to closure. Most States are in competitive processes or opening them. We are going to be needing to make this credit need evaluation very quickly. It is going to be taking place in June and July and August of this year. So we need to have the system in place to meet that kind of timing.

And one other point, and it is one that Mr. Harvey raised, I think is critical. It is going to be important for HUD to have a quick turnaround. You know, the determination of need can't be something that takes a month or 6 weeks or 2 months for them to figure out. We are going to need to have a decision made on the subsidy level in a period of time that is in weeks not months. And if HUD does not have the personnel, which it oftentimes—I think many of you have been at hearings recently where HUD does have a lack of staff in many of their offices—due to personnel problems or other reasons, HUD can't do a quick turnaround, I think that could be a tremendous impediment to the efficient use of credit and could add to the cost by the delays for the developers.

Mr. **Dinsmore**. Well, I don't want to invent problems, but I assume that in anticipating HUD's regulation the National Council has had an opportunity to talk with HUD. I mean, are you aware of problems in connection with the distribution of section 8 monies and CDBG monies to tax-credit projects? Are you aware of issues that are of concern to the National Council and the State agencies?

Mr. **Hendrickson**. We haven't got that far in this discussion. The discussions have not gotten to that level. In dealing with our area office in Jacksonville, we were at the courtesy visit stage, where we described our process to them, and they said, okay, we now understand your process. But we're not at that level, but we need to get to that level very quickly.

Mr. **Leary**. Has the HUD Reform Act created an unresolvable problem here and, the chicken/egg problem that Mr. Harvey described—that requires a legislative solution, or is this something that HUD and the State housing agencies feel is resolvable?

Mr. **Logue**. If I may, I don't think it is an unresolvable situation. I don't know if it is necessarily a chicken and egg situation. The development process is a process that is fairly fluid and generally speaking, you don't step by step go through and say we need this, this and this. I mean there are generally interactions between various players, various sources of funding and financing and subsidy that take place.

Quite honestly, my personal goal for the Department would be to get to a point in time where the State agencies, the State allocating agencies understand the concerns or the process we will use in evaluating the level of assistance the Department provides to such a point where they will know exactly, based on their original analysis of a particular project what they can or would not expect to receive in subsidy assistance from the Department. And in the ultimate goal, I would see—I can envision a situation where the Department, upon certification by a State allocating agency, that they know what our requirements are and have taken those into consideration, could actually rely on the certification of a State allocating agency that they had taken into consideration both the Department subsidy requirements and their own credit allocation requirements and proceed on that basis.

Mr. **Watt**. Do you perceive the kind of turnaround problem that Mr. Hendrickson is talking about? I mean does that——

Mr. **Logue**. I think in the development of regulations clearly there are processes that can initially take some time to work out, and this is somewhat new for both of us, both the State allocating agencies and the Department. Both are requirements that came out of laws enacted at the end of last year. So there is a certain learning curve and understanding of process that is going to have to take place between us, but I think our interest at the Department is not to be obstacle but to produce housing. We do not want our requirements to slow down the development process. On the other hand, we do have an obligation as required by law to assure and certify that the level of assistance that we are providing is no more than is necessary to assure the efficient development of a particular project.

It is a mutual obligation that we both have, and I think we both are going to take seriously, and I have no reason to believe that we will be approaching this from an adversarial point of view. Our interest and the Secretary's interest is to get the funding out and get it into the hands of the people that need it.

Mr. D'ALEMBERTE. The description that Mark gave of this process, is that generally true of other State agencies or is that just Florida?

Mr. LOGUE. I will speak from my past life. I was Executive Director of the New Jersey Housing Mortgage Finance Agency up until 10 months ago, when I came to the Department. We had an allocation process in New Jersey which was almost identical to the process that Mark laid out for you, and I understand that many of the State allocating agencies will be taking on a similar process. I wouldn't know personally how else you could do it and make the type of certifications that are required under the tax-credit law, other than to do it the way that Mark is going to be doing.

Mr. HENDRICKSON. There is one area that I think some States will approach differently. Our process rewards efficient use of the credit up front and then follows up with the credit need. There are some States that in their allocation plans have determined that there is a need for a certain type of housing in certain locations, which may be compared to other housing in other locations using a lot of credit, but they determine they need rural housing in a certain part of Georgia, they are going to do some projects there, and they won't be necessarily competing up front versus other parts of their States.

So they will determine that if they have a need in a certain area that they are going to do something that they have the most efficient use possible for that location and type of housing, but other than that variation, I think this process will be in place in every State.

Mr. DINSMORE. I would like to have one last question on this HUD process. H.R. 1 imposed similar duties on the Farmers Home Administration. I guess the question is directed to both Mark and Jim.

One, is HUD meeting with Farmers Home to coordinate its process, so that you and they are thinking along similar lines in terms of implementing the new duties, and two is the Council also meeting with both agencies to try to see that there is consistency in approach

Mr. HENDRICKSON. We are meeting with Farmers Home, and I think in an earlier draft of our testimony that we edited down a little bit, we had a description of an initial process that we had worked with Farmers Home. It is not final, but I think that we are very close in agreement with them. Farmers Home will make an initial determination of the subsidies they are giving, and then we would follow it with the assumption that those subsidies are in place, then how much credit would be needed on top of those, if any, to make the project feasible. We have even got to these details of very quick faxing turnaround times. They will also, because they are involved, have looked at all of the project up front for reasonable of costs, because in many cases the Farmers Home subsidy will be in the form of a loan, so they will have gone through a credit underwriting process of their own.

So I think we are in very good shape in terms of the negotiations with Farmers Home to have an efficient system. It will be a little bit different in HUD's case, because they are not the lender in a lot of their subsidies, so they won't have the level of familiarity with the project that Farmers Home automatically will have by being a lender. So it will have to be a little bit different.

Mr. **Logue**. We have not any in-depth discussions with Farmers Home. I think there is some question as to what does apply on the subsidy side, whether Farmers Home is even covered by section 102. To be perfectly honest, I'm not sure that they are.

Mr. **Leary**. One of the questions that Mark raised was staffing needs. Mark, was that an abstract observation or——

Mr. **Hendrickson**. No, it is concrete from the Jacksonville area office, which has advised us that in the area of FHA processing that it could take from 13 to 15 months to process an application for FHA insurance on a multifamily loan. So it doesn't necessarily directly relate, but because you're looking at essentially the same staff, the people that understand multifamily lending, and they are critically understaffed at this point to be able to handle their existing workload for FHA insurance.

Mr. **Leary**. I was wondering if that was true with other people and what was the reaction of HUD as well.

Mr. **Logue**. Well, from the perspective of the ability to carry out the requirements of section 102, that really is an additional functional requirement that will be part of our normal underwriting process. So the section 102 aspect of the legislation, once we have a process in place, shall not have any staffing impact whatsoever.

Mr. **Harvey**. Mr. Chairman, I am not quoting now a scientific principle, but an economic one, that time is money in this whole process. We deal in 30 States, and each State is taking a slightly different approach to this process, and therefore, it is very critical to us that some agreement come between HUD and the States on their dual roles toward looking at this credit, and I do suggest that it does differ from State-to-State as to how they are judging and the criteria that they are putting up for their applications. So there may need to be some intensive talk back and forth before a process that is going to be very timely comes out.

Senator **Graham** [presiding]. Excuse me. I apologize for having missed most of the discussion. You said the dual roles. Could you define for me what you're referring to?

Mr. **Harvey**. The dual roles—in the previous conversation, we were going over section 102, which is the role of HUD to make sure that it is allocating no more of its subsidy than is absolutely necessary, and the role of the State agency that they are giving out no more tax credit than is absolutely necessary, and one or the other is going to be the marginal arbiter of how much money is given, and that was our discussion, I guess, while you were voting.

Senator **Graham**. I understand that you have had a good discussion on question No. 3. I would like to ask a final question and then yield to Senator Mack about the level of resources that are going to be available in the State agencies to carry out these new responsibilities.

Mark, we have an analysis of what the States, specifically Florida, propose to do in terms of staffing this function. What do you think the Executive and Congress ought to look to in terms of assessing the adequacy of States' capability to carry out their new job?

Mr. **Hendrickson**. Mr. Chairman, I think that is a good question, but most of us have done these functions before in conjunction with bond programs where we have done credit evaluation, and in the case of monitoring, monitoring of the project. So the basic capability exists to do this type of credit evaluation either with staff that are employees of the agency or in the case of Florida on a long-term system where we use private lenders under a contract basis to do a lot of the credit underwriting.

So the capacity should either be there or is available from the private sector to do this.

But one thing I've got to emphasize. It is a significant resource, staff resource, that you are asking us to commit to this process. I mean, all of my fellow agencies are shifting personnel, adding personnel in our case, to make sure that we can adequately perform the role and the responsibilities that you've given us, but we are doing that with a 9-month program. So at some point there is a danger that the 9-month extension will cause the allocating agencies to be unable or unwilling to commit the resources that we need to build up our staff infrastructure to do these things when we have a program that could disappear at the end of this year.

So not to use this as a pitch for a permanent extension, but of having some extension——

Senator **Graham**. But you do that anyway. [Laughter.]

Mr. **Hendrickson**. At least to make it a pitch for a extension—we would like it permanent, but certainly knowing we have 2 or 3 years, makes it much more comfortable as a manager to commit your staff resources to do it, and I think HUD has the same situation that you are having to reassign and develop certain talents and people are not likely to do that if they think that they are doing it just this one time.

Senator **Graham**. Senator Mack?

Senator **Mack**. I think the only question I have before we go on to the next issue or next question has to do with the point that Mr. Harvey raised and maybe was discussed more after we left, and that was the question of the coordination of the allocation of subsidies.

How serious is that question? What do we need to be looking at from that perspective? Is it something, in fact, that is being worked out, and we should just kind of give enough time for the solution to be developed, or is it something we should involve ourselves in?

Who wants to take a shot at that?

Mr. LOGUE. I will try to outline it. The process and requirement we have under the Reform Act is very clear for the Department's program. We have to develop a regulatory framework that assures that we take into account all assistance that is provided in conjunction with the assistance the Department provides. Our goal is to have a process that is well understood, well defined and easily decipherable by both the users of the tax credit and our programs, because that is where the nexus occurs. When our programs work in conjunction with the low-income tax credit or other forms of State or local assistance, that is where the section 102 requirements come into play.

So for those instances where tax credits are not being used in conjunction with HUD assistance, there really is no nexus, but there clearly is a nexus where the Department's programs interrelate on a project level with low-income tax credit.

Our intention as a department is to have the process established and well understood—and as I was mentioning before, before you came back into the room, I think our goal at the Department would be to get to a level where the credit allocating agencies understand our process to the degree that I could foresee the Department relying on certifications made by credit allocating agencies to the effect that they have considered the requirements the Department has in the allocation of its assistance and evaluating the entire project and their level of assistance provided through the tax credit, and that there would be, not a duplicative process undertaken by both the credit allocating agencies and the Department. We are not there yet, but I think in the evolution of our process that is the goal we have in mind, and we are intent on working very closely with the individual members and the National Council in making sure our process is understood and we understand their process.

Senator GRAHAM. If there are no other comments on question No. 3, I would like to move on to issue 4, which is:

What methods and resources are the State housing agencies and the IRS likely to be able to employ to enforce compliance with tax credit requirements, particularly the low-income occupancy and habitability requirements?

Ms. Reaman—Mr. Blattner?

Mr. BLATTNER. Well, as I mentioned earlier, when the State grants the credit, they file a Form 8610, which transmits the Form 8609, setting forth the amount of credit they have allocated to the individual owners. The requirement is that when the building is put in service and the credits claimed, they attach the Form 8609 to the tax return, where the low-income credit is claimed. We then establish a file, and we monitor that using a building by building identification number. If, in fact, the qualified basis is decreased or the Form 8609 does not accompany a subsequent return, we then pull out that taxpayer's file to determine what caused that change in filing status. We are currently building a system that will match the State report that they sent to us with the individual reports that the claimant, the owners, claimed, and so we will have, really, a dual system monitoring the form that is filed by the taxpayer as well as matching that against the form that is filed by the State.

Senator **Graham**. Comments on that? Yes. Mark.

Mr. **Hendrickson**. I think that this is an issue that was raised in Mr. Ols' testimony that I think is critical to this program. The existing law on monitoring is vague, and it merely requires that if we stumble over noncompliance that we notify the IRS. From our standpoint, IRS has its own process in place with the taxpayers in their returns. But I think that is a situation that—this is something that I am not speaking on behalf of NCSHA, because there is some variance of opinion in different States, but on behalf of Florida, I think it is critical that this program have a clear directive that the allocating agencies monitor the projects on an ongoing basis. And I think if we don't do that, then it is likely in two or three years that you will have a lot of projects out of compliance, most often inadvertently out of compliance, but nevertheless, technically out of compliance, and we will have the potential for the program being killed, simply because no one would take the time to do the monitoring.

From Florida's perspective, despite the vagueness of the directive, we are taking the position that we are going to actively monitor all tax-credit projects from now, including the ones from 1987, 1988 and 1989. We are going to monitor them in exactly the same way we would monitor a project if we had financed it, which includes training for the on-site manager and for the owner of the project. It would include a compliance manual that describes in great detail how they should verify income, what is and isn't income, how they determine that someone is low income. We would follow that up with quarterly and annual reports from each of the developers to our agency. And lastly, we would, on at least an annual basis site-visit each of the projects and check a percentage of their files consistent with the procedures that one does in the section 8 program, when you are monitoring a section 8-assisted project.

I think that level of monitoring will be needed. Again, our experience has been that noncompliance is most often inadvertent. If you get out 3 or 4 years, then the apartment manager probably won't even remember that tax credits had anything to do with the project, unless there is a process to remind them to keep track, because you have turnover of managers of apartments regularly.

So I think we can avoid a problem down the road with aggressive monitoring.

In the IRS testimony, they mention a study they had done of multifamily projects and monitoring it, and their preliminary results of the examinations indicate a very high compliance rate with the requirements. Well, they found that because people monitor the projects, and I think if they do that same study on tax credits, if there is not monitoring, they will find projects out of compliance, not by fraud, but by inadvertent actions of people who fill out the forms.

So I would encourage you in your report and in the extension of this program to require that proactive monitoring by the allocating agency.

Mr. **Blattner**. I would like to just add to that. We have recently developed a form for the State agencies to share the concerns that they can identify—from however they identify the problem—with us to cause us to focus on those returns to determine if, in fact, they are in compliance. That is a new form that will be distributed this year. We ask for the annual certification. That causes the owner to focus on the requirements. Those are the tools that we are using today. The test that we did on the low-income housing tax-exempt bond show a very high level of compliance. So our tests have shown a high level of compliance in another effort. We are trying to leverage the information from the states to produce as strong a program as we can.

Senator **GRAHAM**. Mark, the evaluation monitoring that you have provided to the units that were financed under the tax-free bond program, how did you finance the cost of the administration of that monitoring?

Mr. **HENDRICKSON**. Charged the fee to the developer to do that.

Senator **GRAHAM**. How do you propose to finance the monitoring that you would do under this low-income tax credit?

Mr. **HENDRICKSON**. Charge a fee to the developer as the prime beneficiary of the credit. Then we feel they just sense it is a user fee. It can be done very, very cost effectively. Our experience, and again, we use a contract basis, is that a large project can be monitored for a cost of about $1000 per year and smaller ones for as little as $500. You know, you're not talking megadollars in terms of the amount of credits that you are giving out.

The other thing though is, Senators, when we make someone a loan, we collect a fee every year, and if they don't pay it, we have some way to foreclose and other actions to deal with it. One of the odd things with the credit is that we don't have—you know, once we give someone a credit, we can't be in the annual fee collection business, because if they don't pay us, there is really very little we can do. So what we are struggling with is a way to try to collect fees up front from the developers to cover the cost of monitoring over an extended period of, you know, 15 to 30 years out. So it is not as simple as the fee collection in the other, but that is how we finance it.

Senator **MACK**. Yes. I wonder if I might just ask you, you indicated a little earlier that there is apparently a disagreement within the association as to this point. I wonder if you could share with us what that disagreement is about or, I guess, a different point of view.

Mr. **HENDRICKSON**. To broadly generalize it, I would say that the States that had active bond programs for multifamily housing and have had experience in monitoring tend to be the ones that are more aggressive about wanting to do monitoring, and those that didn't do multifamily and they don't know to monitor have been more resistant. And you know, that's the generalization.

I think one of the key areas is liability, that if you actively monitor, you are implying that you have a system in place that can find problems. One of the liability questions is that if, in our monitoring, we miss something where there is noncompliance, and we fail to find it, are we going to be liable from a lawsuit from the people, individual investors that have invested into one of those equity funds. And you know, that may be stretching it, but that's we've looked at that area, and we are comfortable that we are OK, but there are some States that worry about that liability, if their monitoring turns out to miss something.

Senator **Graham**. The last question to the IRS representatives. If you are satisfied that there has been a failure to perform, either in terms of habitability, or eligibility of persons who are occupying the units, what sanctions are imposed?

Mr. **Blattner**. Well, we don't have much experience with the people who claim the credit, but we have disallowed 225 claims directly on the first year credit, and we have started investigations in various districts throughout the country. We have had evidence referred to us by some State agencies, that we in turn have referred to our criminal investigation division for appropriate action. So I think it depends on, was it unintentional or was it absolute fraud to try to claim the credit? Up to this point, we do not have enough experience to really draw a conclusion that there is widespread noncompliance.

Senator **Graham**. What does the law say are your remedies in the event that you do find noncompliance?

Ms. **Reaman**. In a case where a low-income unit is no longer habitable because of violations of building codes, the code provides for a reduction in the qualified basis, which would result in a recapture of a portion of the credit.

Senator **Graham**. What about if the violation is that a noneligible family is occupying a unit?

Ms. **Reaman**. That would also result in recapture, or in a situation if the tenant's income goes above the amount that is designated as low income, the owner has the opportunity to rent the next available unit to another low-income individual. If that does not occur, then again there will be recapture.

Mr. **Haynsworth**. If I may interject, if there is recapture and the unit is no longer eligible, the way the syndications are structured, there is a economic penalty to be paid by the general partner, because it is the investor who really suffers when that happens, because the investor loses something he paid for, and we do have economic penalties to the developer. So at least on projects where there have been investors, it is industry practice to create economic disincentives not to comply with what was originally projected.

Senator **Graham**. Any other comments on issue No. 4?

Mr. **Ols**. Mr. Chairman, I compliment Mark for what he has set up and what they have got, but being that they might be a proactive one, and I think that is what we are alluding to in our statement, that there is no real requirement that any State do this, and I just would like to endorse his program, and it may be a good model that might be able to be used by other States if they are not into that endeavor at this point.

Senator **Graham**. The final issue is: With the prohibition established against the combination of the tax credit subsidy with the section 8 Mod Rehab rent subsidy, what issues remain that are specific to the interplay between the tax credit and section 8 subsidy programs?

Mr. Logue, we got earlier into a discussion of project versus nonproject subsidies.

Mr. LOGUE. I think the area—now that the tax law prohibits the use of tax credits in conjunction with Mod Rehab, the major vehicle for potential interplay between HUD subsidy programs and the tax credit has been removed; however, other types of subsidy programs the Department continues with could in a variety of ways be used in conjunction with the low-income housing tax credit, and I think the process we are going through right now and have already gone through, particularly with conforming with H.R. 1, will address those types of problems. That is, the excessive subsidy layering of section 8 assistance and low-income housing tax credits.

I think that in the Department's view is going to assure ourselves that the appropriate level of subsidy is provided when it is used in conjunction with other forms of assistance.

Senator GRAHAM. In the area of Mod Rehab and section 8, we have by law prohibited those projects from participating in low-income housing tax credits. That has become somewhat of a moot point, since Mod Rehab is now essentially a terminated program.

The question is, since section 8 in theory provides for a fair market rent as the basis of the section 8 eligibility, and then with the tenant paying 30 percent of their income towards that fair market rent, why aren't section 8 projects, Mod Rehab or otherwise, inherently inappropriate for the low-income tax credit?

Mr. LOGUE. I think they would be if there are no controls or no processes by which there is an evaluation made as to the level of assistance that will be reasonable to expect in a project. I think the H.R. 1 provisions that came out of the Reform Act do get to that particular point in the project-based type of assistance we would provide. In the tenant-based areas, I think you have a different set of circumstances, because there is no guarantee to the developer that a particular project that he is developing will receive a benefit of a voucher or a section 8 certificate, because that is a choice made by the tenant, by the owner of that certificate. That I think is the differentiation between the project-based type of assistance that I think have posed the most level of concern and the tenant-based type of assistance that may or may not be associated with a particular type of project.

Senator GRAHAM. Just focusing in on the project-based section of the project. If section 8 starts with a rental income that is judged to be what—the fair market rent, which includes profit, overhead, and all of the elements that go into fair market rent—if you have already the determination that the rent level that the landlord will receive is fair and accurate for the market in that community, it seems to me that inherently, by definition, that a tax credit would be surplus; is that correct?

Mr. HAYNSWORTH. I think it can be correct, but I think it also depends on whether the rents are high enough to create a net operating income that is going to create a mortgage that is large enough to cover all your costs. If your costs aren't covered by the mortgage debt, you are going to need equity funds to come into the transaction, and they are only going to be provided by the tax credit.

So really, I think it would depend on circumstances. Under the Mod Rehab Program, for example, getting back to that, in many cases, you had very high leveraged financing. So therefore, you didn't have much or any gap between—if any gap, in some cases between development costs and mortgage loan funds. So therefore, you didn't need that extra equity.

Now when you get back to what you are talking about on the project versus tenant-based subsidy, I think mortgage lenders, when they look at a tenant-based subsidy, they are not going to be willing to loan money based on the section 8 rent. They are going to look at what the market rent is which, in many cases will be substantially less. So therefore, they are going to loan a lot less money, commit to loan a lot less money on that job, which means you are going to need a lot of tax credit on that job to make it work.

So I think really the issue as to whether or not you are going to need tax credit to make a development work, in large part, is a result of looking at whether the mortgage is going to pay for development costs.

Senator **Mack**. Well, it is really just a follow-up on the discussion. In some of our earlier hearings, I think, you know, a number of us got quite nervous about the layering of subsidies almost to the point of concluding that layering is inherently wrong and unnecessary and ends up putting subsidy directly in the pocket of the developer. But I gather from comments that have been made here and other places that layering of subsidies is not inherently wrong, provided that the review of the project, its costs and other points that Mark raised, that you may have to have the layering of the subsidies just to make the project work, and if you, in fact, monitor it correctly, the correct amount of subsidies will be provided and could come from a number of sources. So it is really more important to look at as you see what is necessary to cover the cost as opposed to just whether it is being layered or not.

Is that a fair statement?

Mr. **Haynsworth**. We think it is a very fair statement.

Mr. **Harvey**. We find that a very fair statement. You need the layering of financing in low-income housing, because there is no one program—with possible exceptions here and there around the country—that covers all of the costs to keep the rents as low as you are setting them.

New York is one area where we use tax credits and 1 percent, 30-year nonamortizing financing from the State and the city—we have about six different sources of State and city subsidies and tax credits to get to a rent of under $300 for a two-bedroom, and the operating costs on those alone are over $200, and then you have utility costs. What we really worry about is what happens when that oil bill and energy bill goes up over time and the rents are kept flat as median income in these very poor areas aren't going to be growing at the same rate as costs over time. So that, indeed, we even put more money into the project to take care of problems that may come in year 7, 8 and 9, to make sure that these projects are going to run and be there and there are replacement reserves.

One of the ways that we have taken the tenant-base section 8 is one of the ways you can use that extra money. Since you have got tenant-base subsidy for a few number of years and no bank will lend on that or no mortgage can be supported by that, you can take the extra cash flow, put it back into the project in some kind of a reserve fund for additional expenses over time. And we do that regularly in our underwriting.

Senator **Mack**. Before you respond, let me just raise another issue. It appears that on most projects that some form of layering takes place, and as you have indicated is necessary to make the project economically feasible, basically. And I can't remember the numbers, but at one of the earlier hearings we looked at a project of roughly $12 million or so, and we found out that there were tax credits and there was use of UDAG funds and CDBG and section 8 vouchers or certificates. I mean, it was just—when you got through, it was staggering.

I recall at a meeting we had down in Tampa, Mark, that one of the individuals said, "You know, we would all be better off if we would just recognize that a project is feasible based on the income generated by those who are living there, therefore, we would be better off to provide the tenant with the wherewithal to make that monthly rental payment and get away from these different programs.

But I think one of the thoughts that comes to me as the result of this morning is that again because the bankers and mortgage companies won't lend the money, based on—if the tenants have the subsidy as opposed to the subsidies being made available to the builder.

Mr. **Harvey**. That is absolutely right. Also, there is another part that just supplying vouchers, particularly shorter term, you aren't going to fix up a lot of units that need to be fixed up. And there are a lot of such buildings in neighborhoods. We work on the basis of revitalizing a whole neighborhood. There are lots of abandoned buildings that need to be taken care of if you are going to do anything at all in that neighborhood. And they will not be fixed up by having people walking around with vouchers, unless you flood the whole country with vouchers. Then maybe that begins to affect it. But that has not happened, and I don't see the budget happening for it. And you are right, it is a crazy way to do housing policy, but it's sometimes the only way we've got.

Mr. **Ols**. Senator Mack, you are right on target, and if you remember last summer when we testified before the chairman, and we talked about the problems with that layering at that time, because there were no controls. And I think Mark talked to that, that prior years there weren't any. In 1989, there are broad mechanisms, and they might need some fine-tuning. And I think Jim has even talked about it. We are looking at HUD programs to bring that together. So we have made some positive steps in the latest changes that I think are right on target to where we were trying to go when we first looked at what happened in the mod rehab projects, just using those as an example, not even knowing about the other 70 percent of the projects that were going down that didn't involve Mod Rehab projects.

So I think in that sense, I think it was right as we move forward, and we are making great strides in that latest change, and we just have some tweaking and fine-tuning to do on some of these things.

Ms. **Reaman**. Mr. Chairman, I just wanted to point out one technical point that, although we believe it was the Congress' intention to eliminate the credit for Mod Rehab assistance, the way the code actually reads, only programs with the 4 percent credit and the Mod Rehab will be denied any type of credit; however, that does leave open the 9 percent higher credit, and we are working with the Joint Committee and the Ways and Means Committee to develop a technical amendment that would close up that slight loophole.

Senator GRAHAM. I am looking at section 42(b) of the Internal Revenue Code, as amended by the 1989 tax bill, and it says in defining what applicable percentage means, "a building shall not be treated as described in subparagraph (B) if at any time during the credit period Mod Rehab assistance is provided with respect to such building under section 8(e)(2) of the U.S. Housing Act of 1937."

So what you are saying, there were credits provided under sections other than Section 8(e)(2)?

Ms. REAMAN. No, what I am saying is that the credit is applied by allowing a higher, roughly 9 percent, credit for new construction and rehabilitation expenditures and a lower credit is provided for federally subsidized buildings and existing—acquisition type credit—buildings. The way the code was actually drafted, it only relates to those later categories of buildings, and a technical amendment is needed to include new construction and new rehab expenses.

Since the Mod Rehab Program has been terminated, I think the possibility of having the credit and the Mod Rehab assisted buildings are small, but there could be a situation where there are rehabilitation expenditures that might qualify for the credit and also have the Mod Rehab assistance. This is what we are working to eliminate.

Senator MACK. I just have one last question, and it goes to a point that was raised earlier in our discussions, and I don't remember the exact words, but in essence, the tax credit should be used in areas where the vacancy was——

Mr. FRICKE. What I said, Senator Mack, was the vacancy—and this would just be my opinion—that the vacancy rate for units that ran at or below the fair market rent level would be at 5 percent or lower.

Senator MACK. All right. And I raised the question about geographic allocation, whether we should focus some of our attention to determining whether these tax credits should be allocated on some, I guess, either geographic or—I guess not geographic, but in areas where we can identify the vacancy above that point.

Does anybody have any reaction to that? I don't think you were in the full panel discussion at that time. Will the states and the market pretty well determine that?

Mr. HARVEY. I would hate to see that happen, because I think there is an allocation, a process that's going through, again, with the 1989 act, that the States are thinking very hard about how they are going to allocate these credits and in what priority, and it is frankly one of the tools that they are using to carry out policy. So the tight supply in New York City, Boston, they need everything they can get, and that will be substantial rehabilitation projects.

In other States, there may be certain areas and neighborhoods, where they have in rem properties that they have taken back, that they want to do something about, and they may use the tax credits for that.

Senator **Mack**. Let me just follow this. If I remember correctly, there is an allocation of funds per State.

Mr. **Harvey**. Right.

Senator **Mack**. Now isn't it conceivable that there will be States, in fact, where they have a very high degree of vacancies, therefore, a lesser need for new construction? Yet those States might become very creative in the use of the tax credits and, therefore, you really do have a misallocation. There will be States such as you mentioned that really need more? That we might have resources going into States that don't need it?

Ms. **Reaman**. Mr. Mack, I would like to point out that under the new act we do have a mechanism for reallocating unused credits, and that those credits will be placed into a national pool and that the Treasury will reallocate to those States that do need extra credit allocation.

Senator **Mack**. Does that solve the problem, though?

Senator **Graham**. The fact is that there aren't very many States that are gong to be turning back substantial credits.

Ms. **Reaman**. I think so; you're right.

Mr. **Haynsworth**. I think one of the things that people have to realize, there is going to be a need for low-income housing units. Now there may not be a need, if you are going to have a so-called stand-alone project which uses no other subsidy, if you have a very, very high vacancy rate in a particular State. But I don't think there is any State where there isn't a lack of housing for people who are really low-income people. Now those are the kind of projects where you are going to need some additional subsidies to make the projects work. In some States, obviously, you have more low-income people than others, and there may be another way of doing this to allocate credits on some sort of a need basis, but given the scarcity of subsidies and given the scarcity, relative scarcity of the credit, I don't think there is going to be the utilization of the credit that shouldn't be used in a particular State, absent some sort of abuse or something.

Senator **Graham**. I think what Senator Mack is asking is not an absolute question. I would be willing to certify that every State could justify the number of units that they will be allocated, but it is a relative question. It may be that in some States, which have the characteristic of a vacancy rate in housing that at the market level is available to low-income people, you would be treating them relatively more abundantly than States that do not have that circumstance.

Mark, did you want——

Mr. **Hendrickson**. Yes. You made the key point that there is a need almost everywhere despite the vacancy rates and sometimes the fair market rates are really well above what a low-income person can afford to pay. So I don't think pegging it to the fair market is really the test. If you go to high-income counties, you go to a Palm Beach County, fair market rents are very high, but low-income people in Palm Beach County can't afford to pay $600 a month, and there may be a lot of $600 a month apartments in Palm Beach County. So I think that pegging your analysis to the vacancies under the fair market is really not realistic. You really need to look at what are the vacancies in the units that are affordable to very low income persons in that community and available to them.

Mr. **Haynsworth**. And also decent, safe and sanitary units.

Mr. **Fricke**. I guess, we may take somewhat of a different point of view on that. Again, if you are going to look at the economics of building units or the economics of using vouchers and certificates to house poor people, I think there is a general consensus that the economics to house poor people with vouchers and certificates is, in fact, cheaper. Clearly, there are many areas—most areas in the country where poor people cannot afford rents at the fair market rent level, and that is what vouchers and certificates do. They make up that difference. And I think as Mr. Harvey indicated before in some of these programs, unless tax credits are used in combination with other types of subsidies, in order to get down to the very poor people, by themselves they really do not provide the level of subsidy that is really necessary.

So I think from my own personal point of view I would still go back and pretty much maintain that in market areas where there is a vacancy rate at the fair market rate, say 5 percent or greater, that I would certainly question the need to bring additional housing units on line. And to even characterize those as low-income housing units, to me, as I said earlier, the average income of a person who rents is at about 50 or 60 percent of median income. So when we say we are serving people at 50 percent of median income, what we are really saying is that we are serving the median income of the rental population anyhow, which is a lower income person by definition. I think a renter is generally a lower income person than a home owner. But we are certainly not getting down to the income level of people in public housing, which may be at the 20 or 30 percent level. And as Mr. Harvey indicated, you are not going to do it, I don't think, with tax credits. You are going to have to have additional subsidies.

Senator **Graham**. Mr. Haynsworth, in your earlier comments, you made a statement that the syndicators won't look at the section 8 loan, that they will look at section 8 or what the fair market rent or the nonsubsidized rents are in the community, and that often the market rents are below the section 8 established level, and therefore, they will finance on the market rates. Is that correct?

Mr. **Haynsworth**. Yes, sir. That's lenders and syndicators. In other words, lenders will also only look at what they consider to be the market rents, because they cannot rely on a long-term income stream, given that the tenant can move and go somewhere else.

Senator **Graham**. How common is it for the section 8 established level to be above the market rent?

Mr. **Haynsworth**. To be honest with you, I don't really know the answer to that. We have invested in three or four projects which have section 8 voucher tenants. They are expected to have section 8 voucher tenants. I believe that in those cases, that there is a marginal, maybe 10 percent rent advantage that I am aware of, if they are voucher tenants, as opposed to looking at the market. So there is a potential, I suppose, income stream windfall, if, in fact, those tenants stay with that project over the 15 or 30-year compliance period, for example.

Mr. EGGERS. Mr. Chairman. Yes, from HUD. We have analyzed metropolitan areas, and two-thirds of the metropolitan population live in areas where our fair market rent is lower than the rent you would get from 30 percent of 60 percent of median income. So that in those areas, there is no advantage. In fact, it is a disadvantage to have a certificate holder, whose rent would be capped by the fair market rent. And there's not very many places where our fair market rent exceeds the 30 percent of 60 percent limit by more than 10 percent.

Senator GRAHAM. I think what Mr. Haynsworth was using as the baseline of comparison was not 30 percent of 60 percent, but rather what the market was in that particular community. Is that correct?

Mr. HAYNSWORTH. That's correct, what the market is. But I think what you are saying sort of leads me to—because we have seen not too many of those types of transactions, that may well be the reason we haven't seen a lot of those transactions where people are relying on the section 8 vouchers and certificates to try to make the deal work. But there conceivably could be a situation—and I am aware of, I think, at least one—where there is a rent advantage if you have certificate or voucher tenants. In fact, probably a third—in fact, two-thirds or whatever—in that type of situation, what you might have is an income stream that is higher than what you are underwriting your debt and your equity on, which is what you are driving at.

Senator GRAHAM. Well, I am really drawing on your expertise for another subject that's come before this subcommittee at previous hearings and that is how we go about the calculation of fair market rent, whether we use what I would describe as a public utility approach to arriving at fair market rent or whether we use an assessment of the market of comparable units.

Mr. HAYNSWORTH. We certainly use the prevailing rents. In other words, we look at the prevailing market and we don't automatically just look at 30 percent of 60 percent of median because otherwise we could be investing in infeasible developments. We have to know that the rents are going to be there when we invest in them.

Mr. WEICHER. Mr. Chairman, on fair market rents, we do in fact base them—my office calculates them—we do base them on the rent levels that prevail in the different markets in the United States and the fair market rent in each area is based on the actual rents on actual units that people are moving into, existing units, decent units, in that relevant market area.

With respect to Mr. Haynsworth's projects, given that a certificate holder or a voucher holder can walk away from the project and take the certificate with him and it's not an entitlement program and about 75 percent of the lower income families in the United States don't have a certificate or voucher—and will be used by the underwriting process—that would lead you to rely on something that is not necessarily going to be there.

Mr. HAYNSWORTH. We don't rely on it. My point is we rely on what we think the market rents are at the time.

Mr. **Weicher**. I see.

Senator **Graham**. Mark, in the case of Florida—and if you could provide us with some information on other States—what is the current ratio of applicants for credits to credits available to be allocated?

Mr. **Hendrickson**. Last year, we had 160 or thereabouts applicants and enough credits to do about 90 projects. Since we only had ¾ of the year of allocation this year, I think we will be at least 2-to-1, possibly 3-to-1 over-subscription of applicants to credit. I think a 2-to-1 would probably be a good guess nationally, which is fine from our perspective because our competitive process for things other than efficient use of the credits that were put in place works best when you have more applicants than you have funding. So the things that we have done in Florida to encourage local governments to bring resources to the table and other public policies in other States are best served when you have that kind of competition.

Senator **Graham**. I'd like to close with a question that was raised earlier and that was the issue of where do the people who get placed in these low-income tax credit assisted units come from?

I'm concerned about the fact that most communities have a long waiting list which is developed by a local public housing agency. Granted the fact that many people on that waiting list will not reach an income level where they can be an applicant for an income tax assisted unit, let's say that on a waiting list of a thousand people there were 100 who did meet that level.

Are there any ways in which those people are identified and recognition is given to the fact that they have been diligent in trying to find appropriate housing and have been assigned a priority?

Mr. **Hendrickson**. Well, I can't speak for all States in this area, but in Florida's competitive scoring system we award points to the developers who have an active plan to notify people on public housing waiting lists of the availability of units under the tax credit program and can not only say that they will do it but present an operating plan between themselves and the public housing authority to do that.

So I think it's very easy to get people to at least notify them. If you have a competitive scoring process, you may win or lose over 5 or 6 points out of a 1,000 and the marginal cost of that kind of an effort is almost nothing. So I think in our scoring process we can get most developers who win tax credits to do that.

I think the more important point, though, Senator, is that to reach people whose income may be $3,000-$4,000 a year may take a subsidy beyond a nine percent credit.

Senator **Graham**. It may be that 90 percent of the people on the public housing list just economically aren't applicants for this, but if there are 10 percent that are, should they be given some special preference? These are people who have been in the community for a period of time. They have taken the effort to be on a list. I think fairness indicates that they should be given some recognition for that as opposed to a family of similar income who may have just arrived in the community where this unit is going to be located the week before it opened its doors.

Mr. **Hendrickson**. I would agree with you, Senator. I think that our scoring process will reflect that and I would hope that most other States have a similar process. I think the direction is there. I think the 1989 act told us to give that priority and I think that in the Congress' oversight of the tax credit program that at some point a year or so out you should look at all of the State allocating plans to make sure that we did put in that preference that you had directed us to do.

Mr. **Harvey**. Could I add to that, in that we work with over 100 non-profit groups and the non-profit groups basically are neighborhood-based and we're dealing in very poor areas in most cities.

Our applications on new tax credit units of over 5,000 units have averaged about 10-to-1 applicants to each unit that's available. That shows you the extraordinary need.

In a lot of cases, we are below the 60 and 50 percent. That's the other subsidies that get it down to the levels of real need in a lot of those neighborhoods.

There are some very active plans that come out of that. They have to publicly advertise, but there is an informal waiting list that also comes out of those communities as they show their plans to do further redevelopment.

I think the non-profits are very good from that point of view because their whole point of view is to do a whole redevelopment of a neighborhood and to have a community that's going to be there for some period of time.

Senator **Graham**. A concluding question that we have typically been asking is, so you have any recommendations of what the Congress should be doing in terms of its oversight responsibilities and continued monitoring of these issues.

[No response.]

Senator **Graham**. Well, if you don't, we can consider ourselves relieved.

Thank you very much for your participation. It's been an extremely helpful hearing.

If anybody wishes to file a statement with the committee, we would be pleased to receive that. The record will remain open for 30 days for that purpose. I would also alert you that we might be submitting some additional questions after we have a chance to review the transcript and we would appreciate your further indulgence. Thank you.

[Whereupon, at 1:10 p.m., the hearing was adjourned.]

[The prepared statements of all witnesses follow:]

STATEMENT OF

WILLIAM E. HAYNSWORTH

SENIOR VICE PRESIDENT

THE BOSTON FINANCIAL GROUP INCORPORATED

BEFORE THE HUD/MOD REHAB INVESTIGATION SUBCOMMITTEE

OF THE COMMITTEE ON BANKING,

HOUSING AND URBAN AFFAIRS

APRIL 27, 1990

Mr. Chairman and Members of the Subcommittee: My name is William E. Haynsworth and I am Senior Vice President of The Boston Financial Group Incorporated, Boston, Massachusetts. I appreciate the opportunity to appear before you today.

Boston Financial, originally founded in 1969, has been deeply involved in investing and managing low income housing since the formation of the company. We have had experience in the HUD Section 221(d)(3), Section 236 and Section 8 programs. Over the past twenty years we have raised over $735 million that has funded 77,000 units for families of modest means as well as the elderly and the handicapped. Our property management division is also very involved in low-income housing. They are one of the largest property managers in New England, managing over 13,000 apartment units, 85% of which serve low-income persons and families. Low-income housing programs, like the current tax credit program, help to ensure that individuals who most need our help will continue to have a secure and attractive place to live.

In early 1987 we became the first company to sponsor a publicly offered low income housing tax credit investment partnership. We are currently offering our fifth such fund and we are proud to say that we have raised over $290 Million in equity which has been invested in 170 tax credit eligible properties containing approximately 15,700 units over the past three years. These properties have an aggregate cost of about $875 million.

Before proceeding to respond to the questions raised in your invitation, I do wish to make two brief points. The Congress is rightly concerned that the low-income housing tax credit program operate efficiently and effectively, particularly when used in conjunction with other forms of subsidy. The reforms included as part of the Omnibus Budget Reconciliation Act of 1989 (OBRA), especially those requiring state agencies to develop allocation plans and conduct project-by-project evaluations, should assure that the credit program will operate in the manner Congress intended. The OBRA reforms complement the provisions contained in the Department of Housing and Urban Development Reform Act of 1989. Those provisions require HUD to take into account other subsidies, principally the tax credit, in determining the amount of HUD subsidy necessary for a particular project. However, let me note that I am deeply concerned that HUD and the states effectively coordinate their responsibilities. Before taking significant new action in this area, Congress should provide sufficient time to assess the 1989 reforms.

The OBRA provisions stemmed in large part from housing industry suggestions which were contained in the Mitchell-Danforth Task Force Report. The concerned community -- those who build, develop, finance and manage low-income housing and the agencies who administer the credit program -- have an investment in the future of this program and understand that its future depends upon our responsible use of this subsidy.

We must permanently extend this program. Development of low-income housing is a long term process; developers must know that the credit will exist in the future so that initial development decisions can be made now. The uncertainty engendered by short term extensions discourages needed housing development. It will also drive many developers from the business, and dissuade new and capable entrants, particularly small and minority developers that we desperately need but who may not have the ability to take the same degree of risk that more established firms can afford to take. Moreover, state allocating agencies are being asked to devote substantial resources to administering this program; it is unfair and unrealistic to require this commitment if the program's future is uncertain.

Now I am pleased to respond to your questions.

1) What data is now available regarding the use of the low-income tax credit? Is the targeted tenant population benefitting from the credit? What Federal and State or local non-tax subsidies are being used in combination with the credit?

What variation in project risk and rate of return is identifiable at this time? What housing supply conditions characterize the markets where the credit is being used?

The National Council of State Housing Agencies (NCSHA) has compiled the best data base concerning the use of the credit. I will defer to NCSHA's data.

The credit is allowable only with respect to units occupied by tenants whose incomes are less than sixty or fifty percent of median income (adjusted for family size) depending upon the owner's election. Our own experience is that 94% of the projects in which we have invested are 100% low-income. In the balance of these projects, low-income occupancy ranges from 25 to 95 percent. The credit program provides a strong incentive to developing 100% low-income projects since there are no tax benefits or other subsidies available for market units. Credit assisted projects address only a small portion of the housing crisis facing low-income Americans; additional assistance must be provided to provide a meaningful solution to this problem.

Our experience shows that the vast majority of projects in which we invest are assisted by various forms of federal, state or local subsidies. Among the federal programs utilized are the Farmers Home Administration Section 515 program; the HUD Community Development Block Grant program; the HUD Rental

Rehabilitation Grant program; the HUD Housing Development Grant program, although appropriations for this program have been discontinued and the HUD Section 8 certificate and voucher programs. Because these Section 8 programs are tenant based, not project based, we essentially ignore these subsidies in underwriting projects due to the possibility that the certificate/voucher tenants will vacate. In addition, the Section 8 Project Based Assistance program may be used in the future, although we have had little experience with this program to date because regulations governing this program were only recently issued. A number of states have their own assistance programs: Florida, New Jersey, Delaware and Maryland are among states that have second mortgage programs. The Massachusetts SHARP program essentially provides an operating subsidy which allows rents to be lower.

Prices paid to developers in the form of capital contributions do vary with perceived risk. A very safe project, one with a long term project based subsidy, could command approximately ten to fifteen percent greater capital contribution than a project without this level of safety. Of course, other factors such as project location, financial stability and track record of the sponsors, project design, mortgage loan financing terms and general market conditions also help determine prices paid.

We do not have data on the relationship between the use of the credit and housing supply conditions on a national basis. However, before we invest in any project we conduct a market feasibility study to make sure that market conditions are conducive to development in that community. If we find an oversupply of housing, we generally will not invest. Projects developed without subsidy are predominantly located in relatively high median income, low cost areas because of the way the program works (i.e., rents are tied to median incomes). This situation may be affected somewhat by the provisions of OBRA which allow up to 30 percent more credit to be allocated to projects in certain "difficult development areas," where costs relative to incomes are high, and in "qualified census tracts," where at least 50 percent of the population has an income below 60 percent of median. However, because these areas have yet to be designated by HUD, it is too early to determine what impact these provisions will have.

2) How can the net capital invested in low-income housing with the inducement of the tax credit be maximized? Are there alternative, feasible means of inducing investment in housing for low-income families that are more likely to produce more housing units at less cost than the tax credit mechanism?

Reduced to its basics, the role of the credit in project development is to fill the gap between project costs and mortgage debt. One of the most pressing problems faced by the low income housing industry today is the lack of mortgage financing. FHA coinsurance has been terminated, full FHA insurance is not realistic today and commercial banks and savings and loans are very reluctant to lend against any type of real estate. Tax-exempt bond financing generally does not work principally because the existence of such financing limits the project to the 30 percent present value tax credit, which often does not create sufficient equity for the project. Even where conventional mortgage financing is available, generally it either has a very low loan-to-value ratio or it is augmented by second mortgages from state or local governments. Thus, in many situations, the equity produced by the credit plays a very large role.

The federal government can help make the credit a more efficient tool by promoting the creation of programs which provide debt financing. This financing may require the development of new subsidy or government insurance programs which would be tied to the credit program. I would be pleased to work with the Committee to develop such programs, which perhaps could be included in housing legislation which will be considered this session. However, such programs would entail their own costs.

To the extent that the government wishes to stretch credit dollars as far as possible, then providing mortgage financing programs will greatly assist in this goal.

In making the determination of project costs, it is necessary to keep in mind that costs cannot be confined to simple bricks and mortar costs. Sufficient incentives to attract private sector participation must be present and there must be provided sufficient funds to cover unexpected operating difficulties. Hopefully, the federal government has learned its lessons from past programs that thinly capitalized project sponsors will be unable to handle the financial responsibilities of projects than run into unanticipated problems.

Furthermore, the investment markets in which we raise funds will demand a certain return, most of which is produced by the existence of the credit and which is largely dictated by the risk perceived with the investment. Obviously, no rational investor will invest funds for an 8 percent return when fully insured certificates of deposit will yield the same return. Certain risks are inherent in investment in any real estate and little can be done legislatively with respect to those risks. However, investors also perceive a risk in the federal government's commitment to this program and they recall with unpleasant memories how their tax benefits were suddenly taken from them after the Tax Reform Act of 1986. These concerns have a very real impact on the rate of return demanded by investors and consequently on the efficiently of the program. If we were able to raise more from investors per credit dollar, those funds would be available for investment in projects.

While I understand that no Congress can absolutely bind a future Congress, a permanent extension of the program would be tremendously helpful in assuring the investment public that the credit is not about to be retroactively terminated. In addition, statements of support from Congressional and Administration leaders would lend support to our efforts to convince investors that they are making a safe investment.

The question of what is the most effective method for inducing investment has been debated for years by housing experts and has no easy answer. Our experience shows that investors traditionally have responded most favorably to tax-based incentives for investment in low income housing; generally, cash returns are either limited by regulation or are difficult to achieve as an economic matter. Possible appreciation in value has played a part in investment decisions, but it is unrealistic to consider that factor now in light of growing concerns about the preservation of the existing stock of low income housing. Thus, the tax incentive produced by the credit mechanism is the best way of inducing investment from the public in low income housing.

The broader question is the most efficient method of federal assistance to produce low income housing. Again, there are no easy answers and in fact, there is probably no single answer. The government must have different solutions for different types of markets and to meet a range of different goals. Over the past twenty years, the Congress has developed just about every type of assistance program possible: mortgage subsidies (Sections 221(d)(3) and 236); rental assistance (Section 8); upfront grants (HoDAG and UDAG); direct federal loans (Section 202) and block grants (Community Development Block Grants). Each of these programs has its notable successes and identifiable problems. A flexible approach is best; allow state and local governments, under broad supervision of the federal government, to design the particular type of subsidy mechanism that fits its needs. This appears to be the approach taken in the pending National Affordable Housing Act which the Committee will be considering next week and I commend the legislation's co-sponsors, including Chairman Graham, for a very wise approach.

Regardless of the subsidy mechanism involved, there will always be a key role for private investment that can be best spurred by the continuation of the credit program. While there is a cost in the process of raising capital, there are substantial costs to the government in administering even a direct grant program, which might otherwise look like a more efficient mechanism.

There do appear to be some distinctions between the net capital raised by non-profit sponsored syndication entities and publicly offered for-profit entities. Non-profit syndications typically involve large corporate investors which invest up to several hundred thousand dollars in a single transaction. For-profit syndications, of the type that Boston Financial has specialized in over the past three years, may involve corporate investors but the vast majority of our funds are raised from individual investors. Because non-profit syndications involve corporate investors who are "accredited" within the meaning of federal securities laws, such transactions may be done on a private placement basis without the necessity of a very expensive and time consuming SEC registration. Furthermore, non-profit syndication organizations are able to place interests directly with corporate investors without the necessity of brokerage firms. Publicly offered funds to individuals must be registered with the SEC and with state securities regulators in each state and we must rely upon the brokerage industry to produce investors for us. Because the amount of credit that an individual can use is generally limited to no more than $8,250 per year under the passive loss rules of the Internal Revenue Code, we must attract thousands of investors to raise sufficient funds to meet the needs of credit projects. Brokers who identify such investors generally demand a commission of approximately eight to nine percent of funds raised.

Offsetting somewhat the advantage enjoyed by non-profits is that corporate investors generally ask for and receive a higher current return than individual investors. Moreover, most corporate investors will pay their capital contributions over time; six or seven years is not unusual. This slower pay-in entails costs for project sponsors, who must often arrange for some type of "bridge financing" while capital is being paid. Publicly offered funds, such as Boston Financial's, generally collect capital in one installment upon admission to the partnership.

There is a role for both types of syndication entities. My research indicates that approximately $500-600 Million has been raised in the corporate market, about half of which has been through non-profit syndications. The various publicly offered funds have raised almost $1 Billion over the past three years, most of which is from individuals. The non-profit/corporate market cannot possibly meet the needs generated by all the credit eligible housing that will be produced over the next several years. Many corporate investors are motivated by social goals and the positive publicity that investment in housing generates and thus, they may not be willing to repeat the investment. On the other hand, the ability of the various public funds to raise funds is not unlimited. Indeed, results thus far in 1990 cause me concern that our markets are becoming "tapped out".

3) How are the state housing agencies and HUD implementing the 1989 changes in law that require that the tax credit subsidy and HUD's non-tax subsidies be provided in an efficient manner that takes account of the availability of each type of subsidy?

It is simply too early to determine how well the states and HUD are implementing their new responsibilities mandated under OBRA and the HUD Reform Act. States are still in the process of developing allocation plans; very few allocations or reservations have been made, to my knowledge. HUD has still not published its proposed regulations governing their evaluation process.

In terms of capacity, as a general statement, I am tremendously impressed by the dedication and effort that the states have demonstrated in gearing up for their new role. NCSHA has provided invaluable training and backup to the states. The level of expertise and sophistication in the underwriting process will vary greatly between states. States with experience in the issuance of tax-exempt multifamily bonds are likely to have a better grasp of the evaluation process because of their prior experience. Over time, the process will even out as the states learn to adapt to the new system.

As previously stressed, the states and HUD must develop a system for coordinating their responsibilities. Each agency will be inclined to want to make its decision last so it will know how much the other party has "brought to the table". The results can be a stalemate unless there is real cooperation between all concerned. Encouraging discussions have taken place between HUD and NCSHA on this issue. However, each of the states and their counterparts in the HUD area offices must also be in contact.

The HUD subsidy programs that are likely to be combined with the tax credit are not numerous. Community Development Block Grant loans are likely to be utilized, particularly because such projects may receive the 70 percent credit under an amendment contained in OBRA. Section 8 Project Based Assistance may also be used with the credit as will tenant based certificates and vouchers. With respect to these Section 8 programs, our experience has been that lenders will disregard these subsidies in determining mortgage amounts because the existence of these subsidies cannot be assured during the mortgage term. Similarly, when we evaluate a project, we do not assume the continuation of these subsidies beyond a five year term in the case of PBA subsidies (the length of the Housing Assistance Payments Contract) or a one year term in the case of tenant based assistance. Finally, although they generally cannot be taken into basis for purposes of calculating the amount of credit; Rental Rehabilitation Grants have also been used in conjunction with credit eligible projects.

4) What methods and resources are the state housing agencies and the Internal Revenue Service likely to be able to employ to monitor and enforce compliance with the tax credit requirements, particularly the low income family occupancy and habitability requirements that apply for a minimum 15 year period?

At the very end of the OBRA legislative process last year the Congress inserted a rather vague requirement that states develop a method, as part of their allocation plan, to notify IRS of any noncompliance of which the state agency becomes aware. It is not clear what the states are required to do under this provision. Nonetheless, we would encourage a process of state monitoring of credit projects, provided that the process is reasonable and not burdensome or overly costly to project sponsors. In fact, as sponsors of public funds, we take very seriously our own responsibility to monitor project compliance in order to protect the rights of our investors and would welcome whatever assistance the states can give in this endeavor. We conduct our own annual due diligence on project general partners to ascertain compliance and we require audited financial statements for each project. We have a team of asset managers dedicated solely the monitoring of the projects in which we participate. They monitor quarterly financial information, tenant qualifying procedures, property operations and also make site visits to ensure that the property is being well-maintained.

It is industry practice for investment partnerships to provide for potentially severe penalties against project general partners in the event of noncompliance with statutory requirements. Generally, our partnership agreements will mandate a reduction and/or return of capital contributions in the event that the amount of credit actually realized is less than projected levels, which shortfall would in all likelihood arise from a failure of the general partner to adhere to the rent and income rules. Furthermore, under certain circumstances, which could include negligent management of the property, we can seek to remove involuntarily a general partner. We also have other remedies in our possession, including the not insignificant penalty of refusing to do further business with project sponsors who do not live up to expectations. We have interests to protect--our own, our investors' and our belief that we have a responsibility to the taxpayers to act prudently--and we do not hesitate to enforce our rights when necessary, although I should hasten to add that such situations have very rarely occurred.

The IRS has neither the personnel nor the experience to undertake project evaluations. That task should be left to the states, which could delegate the task to outside contractors, such as certified public accounting firms. Such firms might be asked to report "exceptions" found in their regular audits to state agencies. To be effective and not overly burdensome, the monitoring system should take into account the potentially enormous task at hand. It would seem not unreasonable to require project sponsors to submit annual financial statements to state agencies for their review; the information contained in such statements will assist the agencies in determining whether the income eligibility and rent restriction tests are being met, which are really the issues that require examination. Either in response to such statements or on their own initiative, states could undertake to do on-site project inspections on a periodic basis, although I would suggest that yearly inspections may be too costly and unnecessary, particularly if project partnership auditors were required to test compliance in a manner similar to the way they test compliance with HUD regulations and report any "exceptions" to state agencies. Furthermore, such on-site inspections should require only a sampling of units in the first instance. If a sampling turned up a problem, a more thorough analysis could be undertaken. Practicality must be balanced with the legitimate need to monitor ongoing compliance with income and rent restrictions.

In any event, the question of cost cannot be ignored. The costs of the compliance system should be shared equitably between the federal and state governments and project sponsors.

5) With the prohibition established against the combination of the tax credit subsidy with Section 8 moderate rehabilitation rent subsidy what issues remain that are specific to the interplay between the tax credit and Section 8 subsidy programs?

I have already discussed the limitation on the use of the credit with tenant based Section 8 and with the PBA program, in response to question 3. State agencies should consider the existence of vouchers and certificates, but should make adjustments in the amount of credit to be awarded only in the event that the existence of the certificates or vouchers results in a higher mortgage amount, which is highly unlikely since lenders will not lend against such subsidies. The problem is that vouchers and certificates are a transient resource; the tenant can vacate at any time after the lease has expired and there is no assurance that the owner will be able to rent to a non-certificate/voucher holder at the same rent. To assume the continued existence of a short-term subsidy places the continued financial viability of the project at risk; tenants also suffer when projects experience financial difficulties. Also, a similar problem exists with the PBA program due to the short-term nature of the HAP contract (five years). I do not believe it is feasible for HUD to take into account the existence of tax credit assistance in distributing vouchers or certificates since the tenant has and should have the right to choose their own housing.

Given the inability to use the credit with the Moderate Rehabilitation program and the limitations on the use of other Section 8 assistance described in the preceding paragraph, the question of whether the credit subsidy is too generous in the Section 8 context has been rendered largely moot. However, it is impossible to make a general statement about whether the credit might be too generous. Some projects required the full amount of rent and the additional equity produced by a full credit allocation; in other projects such a combination may have been too generous. The reforms contained in the 1989 legislation were designed to meet this very problem. Congress should evaluate those reforms after sufficient time has elapsed before any further action in this regard is taken.

Thank you again for allowing me to appear before you.

■ THE ENTERPRISE FOUNDATION

JAMES W. ROUSE
CHAIRMAN

F. BARTON HARVEY, III
DEPUTY CHAIRMAN

EDWARD L. QUINN
DEPUTY CHAIRMAN

PAUL C. BROPHY
PRESIDENT

WALTER G. FARR
VICE PRESIDENT

PATRICIA T. ROUSE
SECRETARY—TREASURER

TRUSTEES

JOHN P. BOORN
PAUL C. BROPHY
LISLE C. CARTER, JR.
RAYMOND G. CHAMBERS
N. GORDON COSBY
MATHIAS J. DeVITO
CUSHING N. DOLBEARE
JOHN W. GARDNER
SAMUEL GARY
W. H. KROME GEORGE
RONALD GRZYWINSKI
F. BARTON HARVEY, III
ANDREW HEISKELL
JING LYMAN
LOUIS E. MARTIN
CHARLES McC. MATHIAS, JR.
DAVID O. MAXWELL
ROBERT S. McNAMARA
RICHARD D. PARSONS
MILTON J. PETRIE
EDWARD L. QUINN
HENRY S. REUSS
JAMES W. ROUSE
PATRICIA T. ROUSE
ANDREW C. SIGLER
STEPHEN STAMAS
ELLEN SULZBERGER STRAUS
ALEXANDER B. TROWBRIDGE
MICHAEL H. WALSH
ANDREW J. YOUNG
RAUL YZAGUIRRE
BARRY ZIGAS

HONORARY TRUSTEES

COY EKLUND
ERNEST W. HAHN
LEEDA MARTING
CHARLES S. ROBB

Statement of

F. BARTON HARVEY, III
DEPUTY CHAIRMAN
THE ENTERPRISE FOUNDATION

Before the

SUBCOMMITTEE ON HUD/MOD REHAB INVESTIGATION

UNITED STATES SENATE

April 27, 1990

■ 505 AMERICAN CITY BUILDING, COLUMBIA, MARYLAND 21044, (301) 964-1230

Statement of

F. Barton Harvey, III

Before the

Subcommittee on HUD/Mod Rehab Investigation

United States Senate

My name is Bart Harvey. I am the deputy chairman of The Enterprise Foundation, which for eight years has worked across the country to provide decent housing for very low-income people. The founder and chairman of The Enterprise Foundation is James W. Rouse, who along with David Maxwell, the chairman and CEO of Fannie Mae (Federal National Mortgage Association), headed the nonpartisan National Housing Task Force.

It was my privilege to serve on the Mitchell-Danforth Task Force on the Low-Income Housing Tax Credit which reviewed the current progress of the tax credit, its role vis-a-vis housing policy, and changes that might facilitate its usefulness.

In your letter requesting testimony from The Enterprise Foundation, you outlined specific questions pertaining to nonprofit use of the tax credits. It is therefore useful to describe our organization's structure and relate our experience to the questions posed.

The Enterprise Foundation

The Enterprise Foundation is a national, publicly supported, 501(c)(3) charitable institution launched in 1982 by James Rouse, who has assembled a distinguished and active Board of Trustees drawn from the business, government and housing arenas.

The mission of The Enterprise Foundation is to see that all very low-income people in the United States have fit and affordable housing within a generation and that they have the opportunity to work up and out of poverty into self-sufficiency and into the mainstream of American life.

We are dedicated to developing new systems and new institutions to achieve this goal. Our Rehab Work Group finds ways to cut the cost of new construction and housing rehabilitation, and the Foundation's wholly-owned subsidiary, Enterprise Social Investment Corporation (ESIC), created in 1984, finds ways to finance low-income housing including the use of low-income tax credits.

The Enterprise Foundation has raised over $65 million in grants and loans and more than $118 million in tax credit equity investments from the private sector to house the poor. It is working with more than 100 nonprofit groups in 30 cities. We provide "seed" grant money and technical assistance to these groups. Through this network of neighborhood nonprofit corporations, 11,000 units of decent housing for very poor people are being provided, and 16,000 hard-to-employ people have been placed in jobs through 16 job placement centers.

We are tremendously encouraged by the readiness of local people to organize and work effectively to produce and manage community-based housing. Enterprise works closely with the people of the neighborhoods, with local leaders, and with local governments to understand the problems and find answers. In all its efforts, Enterprise is constantly examining new ways to harness the creativity and disciplines of the free enterprise system to encourage the initiatives of nonprofit groups and finding ways for corporations and other private sector groups to participate in housing poor people in a responsible, meaningful way.

Use of the Low-Income Housing Tax Credit by Nonprofits

By law, each state must designate a minimum of 10 percent of its total annual tax credit allocation for projects involving nonprofit organizations. Nonprofit organizations eligible for the 10 percent set-aside must be organized under Sections 501(c)(3) or (4) of the Internal Revenue Code and must have as one of its purposes the fostering of low-income housing. They must also be involved on a regular, continuous and substantial basis in the development and on-going operation of the tax credit project for the duration of the low-income use.

Since nonprofit groups generally do not use the tax credits themselves, they must form a partnership with a for-profit limited partner which can use the tax benefits through this arrangement. (See Appendix IV). Structuring these partnerships and amassing the equity investments from corporations can be quite complex.

Enterprise's Experience in Using Tax Credits

The Enterprise Social Investment Corporation (ESIC) is a wholly-owned subsidiary of The Enterprise Foundation. Incorporated in 1984, ESIC has evolved primarily as an intermediary to facilitate use of the tax credits by providing direct assistance to nonprofit groups. ESIC helps them put together their financing package, finds the equity investors, structures the partnership, assists the nonprofit in project development issues and oversight, and lends differing levels of on-going technical assistance to projects. In many transactions, ESIC performs as a special limited partner with on-going monitoring responsibilities and duties. ESIC receives a fee of approximately 8 percent of equity funds raised, in most cases receivable over a multi-year period, for its work and to help pay its expenses.

Community-based nonprofits which ESIC typically assists work in a variety of adverse and tight housing markets, such as in inner cities and poor rural areas. Project size is relatively small, usually 20-50 units. Most need a substantial amount of subsidy monies to be financially viable.

Syndication proceeds usually constitute between 25-40 percent of total project funding. The remainder comes largely from public financing sources. ESIC's efforts have been most successful in those states with strong state or local subsidy programs, including:

New York: *The City of New York provides one and two percent first and second mortgage funds as well as rent subsidies. With projects supported by those important subsidies, New York City is the home of ESIC's largest regional equity effort. In 1988, ESIC structured 22 individual project syndications with 18 nonprofit general partners for 915 units of housing for low-income and homeless people in New York City with major corporate limited partner investors. Currently, ESIC is a co-general partner with the National Equity Fund (an affiliate of the Local Initiatives Support Corporation) in structuring a $49 million New York Equity Fund which will provide equity for the development of approximately another 1,000 low-income units in New York. An additional $50 million equity fund is contemplated for 1990.*

Cleveland: *The State of Ohio has both a weatherization program and a separate energy conservation program (capitalized with oil overcharge funds) specifically available to nonprofits to use in syndications. These public sector programs coupled with Community Development Block Grant (CDBG) funds, supplemented by local foundations and the Ford Foundation providing Program-Related Investment (PRI) funds, have made it possible to provide a large stream of project investments through the Cleveland Housing Partnership Equity Funds. Over 376 units of housing, most affordable to families making less than $10,000 annually, have been provided. (See Appendix V.)*

Rhode Island: *In addition to bond financing, the Rhode Island Housing and Mortgage Finance Corporation administers several subsidy programs that can be used in conjunction with tax credit projects. The State of Rhode Island's Rental Subsidy Program provides rental assistance for up to 20 years and the state's Targeted Loan Fund provides up to $20,000 per low-income unit in zero-interest, second mortgage financing for affordable housing projects.*

Often, in addition to assistance from ESIC, The Enterprise Foundation gives technical assistance and makes grants and low-interest rate loans to these same nonprofit groups for their predevelopment costs, operating support, or other project-related support service costs. This assistance is made possible largely by traditional charitable contributions made to Enterprise by private foundations and individuals.

Construction loans or bridge financing typically come from banks and governmental entities.

ESIC also makes sure that all the money raised through the use of tax credits is put back into the project or used by the nonprofit to further support additional low-income housing. More than $118 million has been raised through limited partnerships sponsored primarily by nonprofits for projects involving 5,000-plus units of low-income housing, most of which were substantial rehabilitations and all of which involved corporate investors. Projects involving Enterprise nonprofit sponsored limited partnerships are highlighted in Appendix II.

The 64 corporations which have invested in ESIC tax credit projects are listed in Appendix I. Typically, these corporations receive at least a targeted 15 percent after tax return, roughly equivalent to the corporate hurdle rate, and anticipate transferring the projects to the nonprofit sponsor or general partner at the end of the 15-year holding period through sale or contribution. These corporations act as limited partners in a partnership with a nonprofit group acting as general partner. In some cases, a nonprofit group will be co-general partner with a for-profit developer.

Residual value is not built into project pro formas, nor is it expected by corporate investors. Most corporate participants are making an unusual investment based upon three factors:

(1) safety of investment,
(2) adequate risk adjusted return, and
(3) positive community benefits.

In some cases point (3) is weighed more heavily than the others.

Earlier tax credit projects, when the credit was unknown and untested, produced returns in the low twenties on some projects. However, rates are being driven down by increased competition among syndicators and the new underwriting requirements to be undertaken by the state housing finance agencies under changes made in the 1989 tax act. In almost every case, the corporate investor espouses long-term, low-income use to continue beyond the compliance period as long as the corporation has received its agreed upon rate of return over the holding period. However, no mechanism exists to ensure that low-income use can occur beyond the compliance period.

In this respect, the federal investment represented by the tax credit could be greatly leveraged by the enactment of a below market up-front purchase option to provide nonprofits with an orderly process to acquire tax credit projects as low-income use provisions begin to expire. Current law limits the ability of nonprofits at the outset of the development process to structure such agreements with a for-profit owner. Essentially, nonprofits do not "own" the project, and partnerships are structured so that the stream of tax benefits can accrue to the equity investor.

In 1989, the law was modified to provide individual tenants with a right of first refusal at the end of the compliance period. We believe it is essential to go beyond this concept to provide for nonprofit and other alternative forms of ownership, such as tenant co-ops, and to specify in the law the voluntary choice of a below market, up-front purchase price. (See Appendix III.)

The primary risk to our investors is recapture if low-income use restrictions are not met. To ensure compliance with low-income occupancy requirements, ESIC performs an annual on-site review of tenant income verification files. The majority of projects assisted by ESIC are 100 percent low-income occupied, and tenant incomes are frequently below 50 percent of area median income.

ESIC also deals with risk by applying conservative underwriting, creating on-going contractual relationships with carefully selected nonprofits, providing on-going technical assistance and training, and providing reasonable economic benefits, such as incentive management fees, to ensure that projects are well-maintained.

Conclusion

The use of tax policy in encouraging housing is a long standing American tradition. Debates are waged over the efficacy of tax policy for low-income housing versus direct subsidy. In looking at any such theoretical case, it should first be realized that current tax policy, through the homeowner mortgage interest deduction, subsidizes families of much greater wealth and income and to a far greater extent than those served by the low-income housing tax credit. Furthermore, direct subsidy authority to low-income families has actually been cut by 80 percent over the past decade.

As far as the efficacy of the tax credit, the Joint Tax Committee reported in its General Explanation of the Tax Reform Act of 1986 that this credit is highly targeted. It goes only to units serving low-income families. The credit serves the neediest families, those at 50 percent or 60 percent of median income adjusted for family size, and it serves those families for an expected 15-year period. Under changes enacted in 1989, it provides for a possible additional 15-year low-income use duration.

The program, itself, has witnessed increasing acceptance, in spite of its complexities and some design flaws. In fact, use across the country has increased dramatically from 19 percent in 1987 to 97.8 percent in 1988 according to data collected by the National Council of State Housing Finance Agencies.

The program has been used to put a large number of tax delinqent, city owned, in rem units back into productive low-income use in such tight markets as New York City, Boston, Chicago, Washington, D.C. and many other cities. It has helped mitigate, with new rehabilitated units, the anticipated substantial increase in rents for low-income units as a direct result of the repeal of many favorable tax policies and the decline in the production of such units due to the Tax Reform Act of 1986. In fact, the tax credit program is the only substantial new production program in the country.

Finally, and most importantly, the tax credit draws in a significant new source of capital from corporations and channels it toward achieving a public purpose. In our work, we find that this investment decision on the part of a corporation is what initially draws key executives and the company into participating in charitable aspects of our mission. Business executives, such as James Ross, president and CEO of BP America, which has invested millions in ESIC's Cleveland Equity Fund, subsequently involved himself as chair of Neighborhood Progress Inc., a citywide vehicle coordinating neighborhood revitalization in Cleveland. BP America has been active in its grants programs in community development along with its equity investment.

David Maxwell, CEO of Fannie Mae, has guided his own company in extensive tax credit and grant programs to foster low-income housing. Ed Pratt, CEO of Pfizer, Ted Peck, CEO of Ryland Group, Eli Broad, CEO of Broad Inc., Jim Robinson, CEO of American Express -- all have become personally and corporately involved in addressing their community's problems in housing. The importance of corporate and business sector participation and influence should not be underestimated.

Technical Questions

The preceding comments outline the Enterprise Social Investment Corporation's use of the low-income housing tax credit program. Specific technical questions regarding efficiency, combination with federal subsidies, extended use, capital availability, program reforms, intermediary costs and federal compliance will all be answered in the roundtable discussion.

Many of these issues were taken up and addressed in The Report of the Mitchell/Danforth Task Force on the Low-Income Housing Tax Credit and those recommendations are urged for consideration by this subcommittee.

Thank you.

0021m

Previous Investors*

Alex. Brown & Sons, Inc.
American Express Company
Ameritrust Corporation
AT&T
Banc One Community Development Corp.
The Bank of Baltimore
Bank of New England—Old Colony
Bankers Trust Company
Bearings, Inc.
BP America
The Brooklyn Union Gas Company
Capital Cities/ABC
CBS Inc.
Central Trust Bank, N.A.
The Chase Manhattan Bank
Chemical Bank
Cincinnati Gas & Electric Company
Citizens Bank
Consolidated Edison Company of New York, Inc.
Constellation Investments, Inc.
The Continental Corporation
Dime Savings Bank of New York, FSB
Eastland Savings Bank
Eaton Corporation
E.I. du Pont de Nemours & Co.
Fannie Mae (Federal National Mortgage Association)
Freddie Mac (Federal Home Loan Mortgage Corporation)
Ferro Corporation
Fidelity Bank
Fifth Third Bank
First Federal of Raleigh
First National Bank of Maryland
First Nationwide Bank
Forest City Enterprises, Inc.
The Higbee Company
Hunter Savings Association
Huntington Bancshares Incorporated
J.P. Morgan & Co. Incorporated
Kaufman and Broad of Southern California, Inc.
Maryland National Bank
MTD Products, Inc.
NACCO Industries, Inc.
National City Community Development Corp.
National Westminster Bank USA
Nestle Enterprises, Inc.
New York Life Insurance Company
Parker-Hannafin Corporation
Pfizer Inc.
Premier Industrial Corporation
The Procter & Gamble Company
The Provident Bank
Republic National Bank
Rhode Island Hospital Trust
The Ryland Group, Inc.
The Sherwin-Williams Company
Society National Bank
The Standard Products Company
Star Bank N.A., Cincinnati
The Stouffer Corporation
Sun Company
Sunarhauserman
TRW Inc.
Williamsburg Savings Bank
Wilmington Trust Company

*Corporate investors who have made equity commitments in partnerships which ESIC sponsored or participated in the raising of equity.

ENTERPRISE SOCIAL INVESTMENT CORPORATION
LOW INCOME HOUSING TAX CREDIT PROJECTS

Project	Developer	Units	Project Costs	TAX CREDIT Proceeds
BALTIMORE, MARYLAND				
Springhill Apartments	Housing Assistance Corporation	35	$750,000	$250,000
Lanvale Apartments	Housing Assistance Corporation	37	$2,201,417	$620,000
NRS Townhouses	Neighborhood Rental Services of Baltimore, Inc.	17	$1,287,500	$440,000
Patriots Project	Baltimore Housing Partnership Development Corporation	76	$4,128,000	$1,165,000
Bruce Street Townhouses	St. Ambrose Housing Aid Center	17	$1,395,900	$445,000
St. Wenceslaus	St. Ambrose Housing Aid Center	26	$2,639,000	$1,000,000
Bretton Terrace	Baltimore Housing Partnership Development Corporation	27	$2,408,858	$803,605
Calverton Apts/SRO	Women's Housing Coalition	14	$928,518	$346,018
NRS Townhouses II	Neighborhood Rental Services of Baltimore, Inc.	22	$1,958,911	$800,000
Moser Manor	Susan & George Littrell	26	$1,719,840	$394,000
Alcott Place	Betty Jean Murphy Dan Henson William Struever Frederick Struever Charles Eccles Winstead Rouse	44	$4,093,213	$1,857,224
Greenside Apts.	Schuster Enterprises, Inc.	32	$1,943,900	$461,000
School 181	Otis Warren Harry Prushansky Alvin Blank	100	$8,770,000	$1,260,000
Ashburton	Stanford Bensky Alvin Blank Harry Prushansky	78	$4,296,817	$1,370,000

Appendix II; p.2
1/15/90

ENTERPRISE SOCIA ENT CORPORATION
LOW INCOME HOUS DIT PROJECTS

Project	Developer	Units	Project Costs	TAX CREDIT Proceeds
CALIFORNIA				
Harbor Towers San Pedro, Calif.	Retirement Housing Foundation	180	$9,984,720	$3,820,000
The Fountains Mountain View, California	Mid-Peninsula Housing Coalition	124	$9,896,312	$3,956,723
OHIO				
Cleveland Housing Ltd. Partnership III	Cleveland Housing Network, Inc.	40	$1,046,053	$432,000
Cleveland Housing Ltd. Partnership IV	Cleveland Housing Network, Inc.	40	$1,229,552	$523,000
Cleveland Housing Ltd. Partnership V	Cleveland Housing Network, Inc.	80	$2,450,000	$1,046,000
Detroit Shoreway	Detroit Shoreway Community Development Corporation & J. Christopher Enterprises, Inc.	64 plus $20,853 sq. ft. of comm. space	$3,582,148	$1,390,000
Cleveland Multifamily I	Multifamily Restoration, Inc.	31	$1,120,900	$386,000
Cleveland Multifamily II	Multifamily Restoration, Inc.	41	$1,441,230	$605,730
Cleveland Housing Ltd. Partnership, VI	Cleveland Housing Network, Inc.	80	$2,218,288	$910,080
North Rhine L.P. (Cincinnati)	City-Wide Management Co., Inc. and OTRHM Enterprises, Inc.	45	$2,574,413	$888,500
Lexington Village	McCormack, Baron & Assoc.	96	$7,430,000	$1,500,000 *

* Cleveland Housing Partnership Equity Fund provided a portion of the equity.

ENTERPRISE SOCIAL INVESTMENT CORPORATION
LOW INCOME HOUSING TAX CREDIT PROJECTS

Project	Developer	Units	Project Costs	TAX CREDIT Proceeds
NEW YORK; NEW YORK				
176-180 Eldridge St. (Manhattan)	Asian Americans for Equality	59	$5,212,255	$2,635,000
176 South 8th St. (Brooklyn)	Progress of Peoples Development Corporation	30	$3,175,491	$1,580,000
2038-42 Morris Ave. (Bronx)	Mt. Hope Housing & Powers Contracting	62	$4,805,796	$2,203,000
77-79 Avenue C (Manhattan)	Asian American for Equality	16	$1,911,215	$861,500
2158 Mapes & 2157 Southern Blvd. (Bronx)	New Cretona & Phipps Houses	91	$12,094,095	$5,674,000
250-254 E. 4th Street (Manhattan)	Lower East Side Coalition for Housing Dev.	34	$4,906,494	$2,549,014
101-105 S. 8th St. (POP III) (Brooklyn)	Progress of Peoples Development Corporation	25	$3,092,660	$1,615,500
105 Quincy Street (Brooklyn)	Pratt Area Community Council	12	$1,437,752	$665,000
1965 Vyse Avenue (Bronx)	Aquinas Housing	19	$2,389,000	$1,189,000
264 Echo Place 2474 Marion Ave. (Bronx)	Mt. Hope Housing Corporation	52	$5,779,020	$2,475,000
826 E. 181st St. (Bronx)	BUILD, Inc.	32	$3,316,118	$1,385,000
St. Johns Place (Brooklyn)	Settlement Housing Fund, Brooklyn Neighborhood Improvement Assoc.	69	$7,296,026	$2,784,000
800 Fox Street (Bronx)	Banana Kelly	19	$2,217,360	$900,000
513 W. 159th Street (Manhattan)	Community League of West 159th Street	10	$1,300,624	$565,000

1/15/90 Appendix II, p.4

ENTERPRISE SOCIAL INVESTMENT CORPORATION
LOW INCOME HOUSING TAX CREDIT PROJECTS

Project	Developer	Units	Project Costs	TAX CREDIT Proceeds
NEW YORK, NEW YORK				
208-16 St. Nicholas 202 St. Nicholas (Manhattan)	West Harlem Community Organization	27	$3,006,950	$1,295,000
244-46 Stockholm St. Irving Ave. (Brooklyn)	Ridgewood-Bushwick Community Council	22	$2,610,803	$1,075,000
101 South Third St. (Brooklyn)	South Side HDFC	35	$3,862,571	$1,521,000
306 Union Avenue (Brooklyn)	St. Nicholas NPC	21	$2,605,585	$1,026,000
1417 Union Street (Brooklyn)	Church of St. Mark	89	$8,083,162	$2,976,000
80 Lewis Avenue (Brooklyn)	Progress of Peoples Development Corp.	36	$4,053,000	$1,630,000
Cordelia Cooper Houses (Manhattan)	Stanley Reifer Peter Clinton West Harlem Community Org.	139	$10,538,752	$1,727,000
722 Henry Street (Brooklyn)	Carroll Gardens Association	16	$1,958,171	$791,000
Townsend Ave. Enterprises Townsend Ave. (Bronx)	Mt. Hope Housing Corporation	80	$6,577,962	$3,215,333
Criscuolo Court II Bronx Park South, Vyse Ave. & East Tremont Ave. (Bronx)	Aquinas Housing Corporation	60	$5,037,229	$2,361,617
Community League/Better Living West 158th & 159th Sts., Amsterdam Ave. (Manhattan)	Comm. League of West 159th St.	33	$3,108,325	$1,337,077
Lenox Ave. Apts. Lenox Ave. & W. 114th St (Manhattan)	West Harlem Comm. Organization	35	$2,950,872	$1,212,826
Friendship Houses Stanton, Rivington & Norfolk Sts. (Manhattan)	Asian Americans for Equality	49	$4,342,804	$2,093,776

Appendix II, p.5
1/15/90

ENTERPRISE SOCIAL INVESTMENT CORPORATION
LOW INCOME HOUSING TAX CREDIT PROJECTS

Project	Developer	Units	Project Costs	TAX CREDIT Proceeds
NEW YORK, NEW YORK				
Coalition Plaza E. Second St. & Avenue D (Manhattan)	Lower East Side Coalition for Housing Development	42	$3,678,966	$1,525,299
Groveland Gardens Grove, Jefferson, & Linden Sts. (Brooklyn)	Ridgewood-Bushwick Senior Citizens Council	44	$4,185,392	$1,762,606
Crown Prospect Houses Grand Avenue, St. Marks & St. Johns (Brooklyn)	Brooklyn Neighborhood Improvement Association	110	$9,231,463	$4,223,112
PHILADELPHIA, PENNSYLVANIA				
Multi-family I	National Temple Non-profit Corp.	20	$1,385,311	$570,000
Multi-family II	National Temple Non-profit Corp.	12	$2,064,000	$994,000
PITTSBURGH, PENNSYLVANIA				
Wood Street Commons	Mistick, Inc.	260	$10,000,000	$2,410,000
RALEIGH, NORTH CAROLINA				
Jefferies Ridge	Downtown Housing Improvement Corp.	32	$1,518,159	$595,000
WASHINGTON, D.C.				
Shalom House	So Others Might Eat	93	$3,337,840	$833,000
Southern Hills	Winn Development Corp.	255	$14,563,130	$2,410,000
WILMINGTON, DELAWARE				
Overlook Community	Interfaith Housing Development Corporation	31	$1,480,000	$400,000
Arbor Place	Interfaith Housing Development Corporation	42	$3,375,000	$800,000

GINSBURG, FELDMAN AND BRESS
CHARTERED

April 25, 1990

MEMORANDUM

TO: The Enterprise Foundation

RE: Tenant's Right of First Refusal (Internal Revenue Code Section 42(i)(8))

Problem: The low income housing tax credit, as enacted in 1986, did not permit owners of low-income housing projects to grant tenants, tenant cooperatives or nonprofit organizations a right to acquire such projects for a predetermined price at the end of the fifteen-year tax credit compliance period. The 1989 Tax Act extended the low income use period for an additional fifteen years by requiring the owner to enter into a thirty-year "extended low income housing commitment" with the housing credit agency. In addition, the 1989 Act included a provision which permitted an owner to give individual tenants of the building a "right of first refusal" to purchase the property for a predetermined price at the end of fifteen years. However, the 1989 Act did not provide that the extended use period would terminate upon the exercise of the purchase right by a tenant, subject to limitations to ensure that the tenant does not immediately resell the property for a "windfall." Moreover, the 1989 Act did not extend the purchase right to tenants' cooperatives, nonprofit organizations, resident management associations or governmental agencies. Without these modifications, the purchase option in the 1989 Act is likely to be of marginal utility.

Discussion: One of the primary concerns expressed about the low income credit as enacted in 1986 was the limited duration of the low income use period. Many felt that fifteen years of low income use was insufficient in relation to the amount of subsidy provided through the credit and that mechanisms should be added to promote the continuation of low income occupancy in credit program projects after the end of the fifteen-year compliance period. A leading study of the credit, prepared by The Mitchell/Danforth Task Force on the Low-Income Housing Credit, recommended that Congress take steps to assure continued low income occupancy through an extension of the low income use period from fifteen to thirty years. The Task Force also recommended that Congress encourage the transfer of low income projects to nonprofit organizations, tenant cooperatives and/or tenants after the expiration of the tax benefits attributable to ownership of the project, as did the another leading study, the Report of the National Housing Task Force.

The 1989 Act took a step in the right direction by permitting project owners to give tenants a right to purchase the building at the end of the fifteen-year compliance period in Section 42(i)(8). This provision is similar to a predecessor provision under former Section 167(k)(2)(B). However, the Act did not provide that the extended use period would terminate upon exercise of such purchase right by the tenant. Without such a provision, it is ambiguous as to whether the project must continue to meet the requirements of the extended use provision in the hands of tenant/owners who have exercised their purchase right. For example, if a tenant who exercises a right to purchase a low income unit ceases to meet the low income targeting standards in Section 42(g) prior to the end of the extended use provision, should that tenant/homeowner lose the ability to occupy that unit and be forced to sell or lease it? Presumably not, since the public policy behind tenant homeownership is to encourage precisely such upward mobility. However, Congress needs to clarify that the extended use requirements applicable to the property will terminate upon exercise of a tenant purchase right.

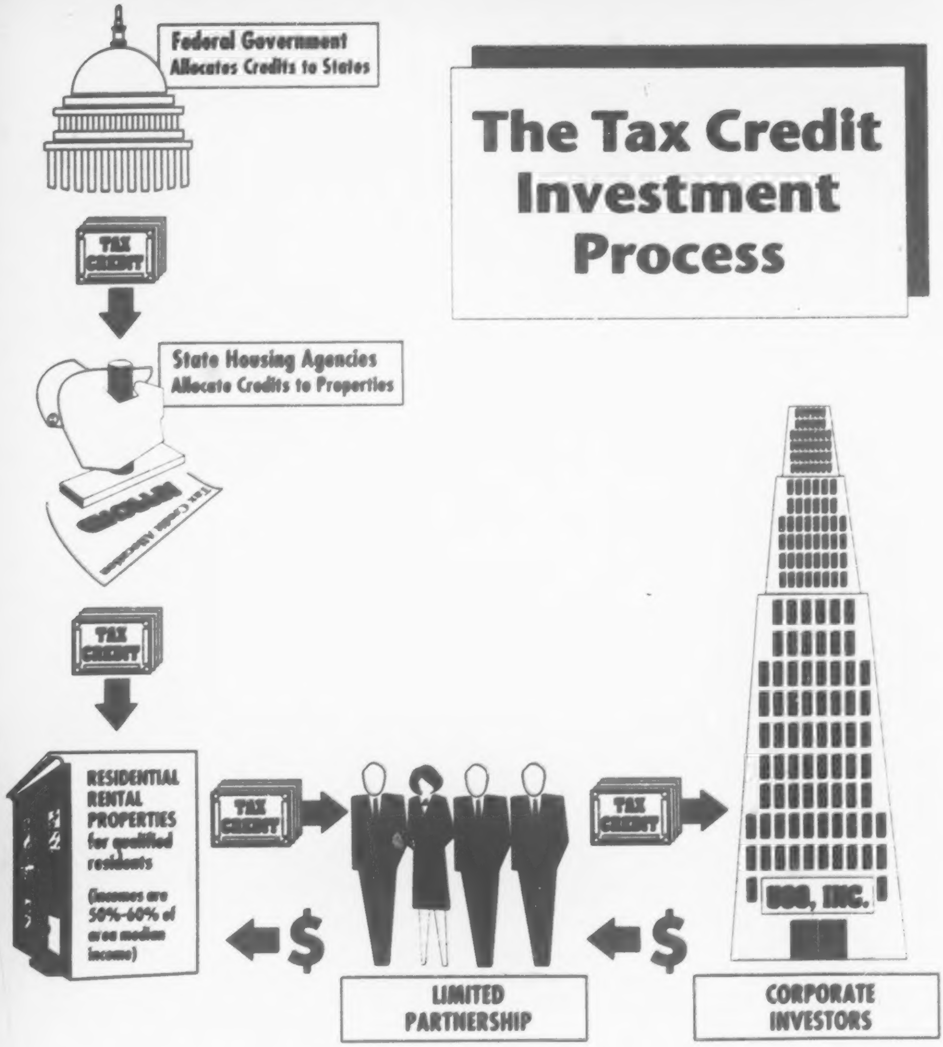
Likewise, the value of the property in the tenant's hands should not be impaired by the presence of the extended low income housing commitment as a restrictive covenant against the property, subject to appropriate limitations on the resale price to ensure that the tenant does not immediately sell the property for a "windfall." For example, in the case of nonprofit-sponsored projects, if a tenant exercises the purchase right, then resells the property during within a ten year period, the sales proceeds should first be applied to repay any outstanding indebtedness, then to return to the tenant any down payment and mortgage principal payments, then to divide the remaining proceeds 25% to the tenant and 75% to the nonprofit sponsor.

Congress should also recognize that certain types of low income housing projects may not be suited for individual tenant ownership, either by reason of the physical condition or configuration of the project, the particular type of financing that may be outstanding, or the lack of a tenant constituency interested in such an acquisition. In addition, in some jurisdictions local real estate laws regarding conversion to condominium or cooperative status may make individual tenant ownership of multi-family projects infeasible or impractical, particularly where some but not all of the tenants desire to purchase their units. In cases where individual tenant ownership may not be possible or practical, it is nonetheless desirable to encourage the transfer of a project from private, for profit ownership to nonprofit organizations, tenant cooperatives, resident management associations or governmental agencies that will seek to maintain permanent affordability of the housing. Accordingly, Congress should extend the right of first refusal under Section 42(i)(8) to nonprofit organizations, tenant cooperatives, resident management associations and governmental agencies.

Recommendations: Congress should amend Section 42(h)(6) to provide that the applicable extended use period shall terminate if a building is purchased by tenants in accordance with Section 42(i)(8), subject to appropriate limitations on resale. In addition, Congress should amend Section 42(i)(8) to provide that a right of first refusal may be granted to nonprofit organizations, tenant cooperatives, resident management associations and governmental agencies as well as to individual tenants.

Appendix IV

The Tax Credit Investment Process


Federal Government
Allocates Credits to States
TAX CREDIT
State Housing Agencies
Allocate Credits to Properties
Tax Credit Allocation
TAX CREDIT
RESIDENTIAL RENTAL PROPERTIES for qualified residents
(incomes are 50%-60% of area median income)
TAX CREDIT
$
TAX CREDIT
$
LIMITED PARTNERSHIP
CORPORATE INVESTORS

The Cleveland Housing Partnership

The Cleveland Housing Partnership

The Cleveland Housing Partnership is a nationally acclaimed public/private initiative that helps provide desperately needed housing for the city's poorest residents.

From 1986 through 1988, Cleveland corporations broke new ground in corporate community investments through their direct equity participation in five low-income housing projects. Building on that experience, the Cleveland Housing Partnership Equity Fund (the Fund) was created in 1988. Its purpose is to generate private investment from Cleveland Tomorrow corporations. Cleveland Tomorrow is an economic development association composed of chief executive officers from Cleveland's 50 largest corporations, to support low-income housing rehabilitation projects in a formal and continuing investment program.

The Fund combines the housing production experience of Cleveland community development corporations like the Cleveland Housing Network and private developers with the capital resources of the Cleveland corporate community. Cleveland Housing Partnership, Inc. (CHP) acts as the managing general partner of the Fund. Technical assistance is provided to nonprofit groups by The Enterprise Foundation (The Foundation). The Enterprise Social Investment Corporation (ESIC), a subsidiary of the Foundation, acts as fund manager.

The success of the Cleveland program is impressive:

- Since 1986, 515 housing units have been rehabilitated in 11 neighborhoods throughout Cleveland.
- A survey of households served by the Cleveland Housing Network projects reveals an average annual household income of only $7,045.
- Over $7 million in private equity has been generated.
- Corporate equity participation has leveraged an additional $7 million in public and $8 million in private financing.

Organization of the Cleveland Housing Partnership Equity Fund

The Cleveland Housing Partnership Equity Fund is organized as a two-tiered limited partnership:

The upper tier or investment limited partnership solicits equity investments from Cleveland Tomorrow member corporations on a once-a-year basis.

The investment limited partnership then invests its proceeds throughout the year in a series of **lower tier or project limited partnerships** which undertake low-income housing developments.

A new investment limited partnership is formed each year which acts as the limited partner in each project limited partnership undertaken that year.

This format enables corporate investments to be assembled into a fund which can readily and efficiently respond to worthwhile low-income, single-family and multifamily housing rental projects. Participating corporations utilize the Low-Income Housing Tax Credits under Section 42 of the Tax Reform Act of 1986 and depreciation, interest and other passive loss tax deductions to create a competitive return.

Management of the Fund

Cleveland Housing Partnership, Inc., (CHP), a nonprofit corporation established in 1988, acts as the managing general partner of the investment limited partnership. CHP's Board of Trustees consists of a majority of members from the corporate community, one member from the public sector and the balance of members from the nonprofit sector with expertise in affordable housing development. The East Ohio Gas Company provides net worth to CHP. The Enterprise Social Investment Corporation (ESIC) provides staff support to CHP's Board of Trustees. ESIC is a subsidiary of The Enterprise Foundation, a nonprofit organization founded in 1982 by nationally-recognized developer James Rouse. More than $12 million in direct grants and loans and through ESIC over $100 million of equity capital have been committed nationally to assist nonprofits in the development of more than 10,000 units of housing for poor people.

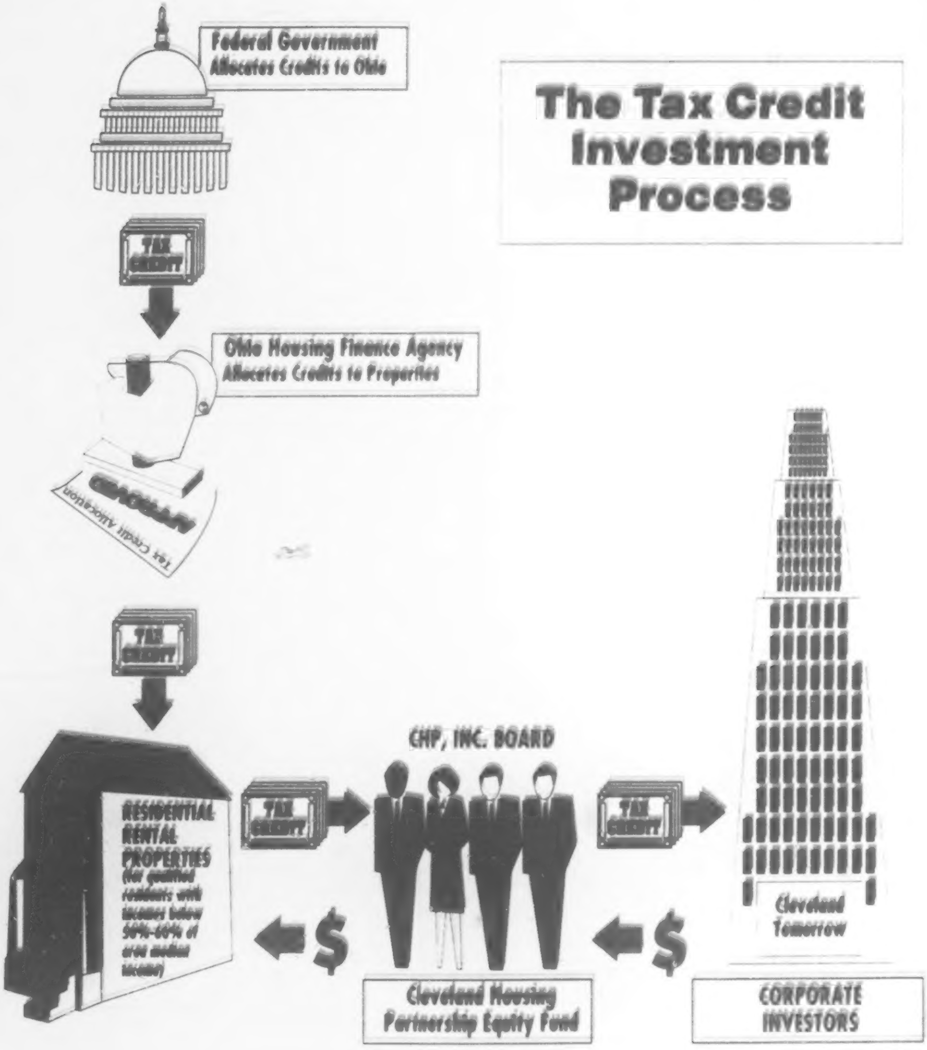
CHP handles all operating responsibilities of the Fund and is charged with making all investment decisions in lower-tier project limited partnerships. CHP has developed a set of standards and investment criteria it uses in underwriting investment decisions.

The management of project limited partnerships in which the Fund invests is the primary responsibility of the general partners of these partnerships. Project partnerships are organized, owned and managed by nonprofit community development corporations and/or private developers. In projects involving nonprofit developers, a subsidiary of ESIC serves as a special limited partner and provides certain management oversight functions. In Cleveland, the project limited partnerships fall into three categories, which are described in more detail in the following section: (1) The Cleveland Housing Network's (CHN) lease-purchase homeownership program; (2) The multifamily program, sponsored by CHN member groups; and (3) larger, special impact projects.

ESIC provides staff support to CHP's Board of Trustees.

The Enterprise Foundation provides technical assistance to developers of project limited partnerships, to facilitate the flow of projects seeking equity investments. The Foundation works directly with developers in providing project feasibility analyses, offering financial packaging assistance, helping with development team assembly, providing construction assistance and supporting ongoing property management. Enterprise also makes grants and loans to support projects.

The Tax Credit Investment Process



Federal Government Allocates Credits to Ohio

Ohio Housing Finance Agency Allocates Credits to Properties

RESIDENTIAL RENTAL PROPERTIES (for qualified residents with incomes below 50%-60% of area median income)

CHP, INC. BOARD

Cleveland Housing Partnership Equity Fund

CORPORATE INVESTORS

TAX CREDIT
APPROVED
Tax Credit Allocation
TAX CREDIT
TAX CREDIT
TAX CREDIT
$
$
Cleveland Tomorrow

Investment Benefits

Under the Low-Income Housing Tax Credit program (Section 42 of the Internal Revenue Code), owners of certain qualified low-income housing developments can reduce their federal income tax liability on a dollar-for-dollar basis by the amount of the Tax Credit over a period of 10 years. Regular C corporations, unlike individual taxpayers, can use an unlimited amount of the Tax Credit to reduce their tax liability (subject to Alternative Minimum Tax considerations) and, with the exception of those that are closely held, can offset business income and portfolio income with passive losses generated by their investment in low-income housing. These passive losses are primarily in the form of depreciation and interest deductions.

Consequently, an investment in the Fund provides Cleveland corporate investors with [illegible] opportunity to respond to [illegible]y's housing crisis while re[illegible]ving unique economic, social and corporate image benefits.

Impact on Low-Income Housing Nationally

Since cutbacks in federal housing assistance intensified in the early 1980s, public/private partnerships have become critical to providing affordable housing. The growing disparity between the decreasing supply of affordable housing and the increasing demand for shelter has demanded creative solutions.

In 1986, Cleveland corporations set the model for corporate participation in public/private partnerships by providing equity capital for a small, scattered-site project developed by the Cleveland Housing Network (CHN) and designed to serve some of Cleveland's poorest families. Since 1986, Cleveland corporations have invested in six single-family projects developed by CHN and two additional multifamily projects developed by CHN's member nonprofits. Cleveland corporations have also invested in the 64 unit Detroit-Shoreway project and the 94 unit Lexington Village II project.

The Cleveland example has been critical to the success of national legislative efforts to establish and maintain the federal Low Income Housing Tax Credit. Moreover, the success of the Cleveland Housing Partnership Equity Fund fueled efforts to create regional equity funds in New York, Maryland, Rhode Island and Ohio. In 1990, ESIC is organizing Enterprise Housing Partners, L.P., a national equity pool that will be accessible to smaller cities and areas in which a regional fund is not practical.

The growth of these equity funds demonstrates the interest of corporations across the country in participating in economically attractive and socially responsible investments, as well as the need to raise equity to finance low-income housing.

Cleveland Housing Network Limited Partnerships I-VI:

Single-Family Program

The Challenge:

Cleveland faces the dual challenge of providing decent housing for poor families and renovating its large and deteriorating stock of older neighborhood single family homes and duplexes.

The Solution:

The Cleveland Housing Partnership has provided much needed equity financing for the development of the Cleveland Housing Network's system for renovating the city's single-family homes. This system not only restores Cleveland's fine stock of older family homes, but also makes the housing affordable for families with average annual incomes of less than $10,000 and provides them with the opportunity for homeownership at the end of an extended lease period.

Since 1986, Cleveland corporations have invested in six single-family rehabilitation projects developed by the Cleveland Housing Network (CHN) and its eleven member nonprofit housing corporations. The project sites are scattered throughout Cleveland neighborhoods in which the member groups operate. Corporate participation in the first four projects was in the form of direct equity investments. Corporate investments in the two most recent projects were made through the Cleveland Housing Partnership Equity Fund.

CHN acquired and rehabilitated the properties using working capital provided by the City of Cleveland and The Enterprise Foundation. The total development costs for these houses average $27,000 per unit. Houses have been leased to families long term, at a monthly rent ranging from $150 to $225. CHN's program is structured to maximize the opportunity for families to take title to the property at the end of the lease term by assuming the outstanding mortgage balance on affordable terms.

In addition to the corporate equity investments, permanent financing for the six projects has been provided through first mortgage loans from Ameritrust Development Bank and Society National Bank; second mortgage loans from the Cleveland Housing Network; and weatherization grants and equity bridge loan financing from the State of Ohio.

The Impact:

With the equity participation of Cleveland corporations, the Cleveland Housing Network now has a working system for the cost-effective rehabilitation of individual single family homes based on a financing structure that both makes the homes affordable and gives families an opportunity to become homeowners at the end of an extended lease period.

Single Family Program:
Creating a Sense of Family

> ***single arent. ladge vanted to ind a new ome for er active our- ear-old on and even- ear-old aughter.***

Madge Weaver was growing weary of living with her children in a small two-bedroom apartment in a building that also housed members of a motorcycle gang. A single parent, Madge wanted to find a new home for her active four-year-old son and seven-year-old daughter.

The Famicos Foundation lease-purchase program with the Cleveland Housing Network provided Madge an opportunity for a fit and decent home that would start her on the road to homeownership.

Madge learned of the program through a concerned family friend. The program enables selected families to lease a single-family home for an affordable rent while retaining an option to purchase it at a later time. Madge's application was accepted.

Madge's enthusiasm for her new Waterson Road home shows in the care and upkeep she puts into it. She loves interior decorating and is looking forward to planting a garden in her large yard. Further plans for her home include covering the back porch with new flooring, paneling her basement walls and painting the children's bedrooms.

Photo by Sharon Hummer

Beyond the space and opportunities her new house offers, Madge for the first time also has a sense of security and stability in knowing that she has a safe and affordable place to live as long as she desires.

"The children are adjusting to their home very well," Madge says. "I can honestly say that home is where my heart is".

Cleveland Multifamily Limited Partnerships I & II:

Multifamily Housing Program

The Challenge:

Most Cleveland neighborhoods have several small, vacant and deteriorated apartment buildings which are a blighting influence on the surrounding neighborhood.

The high fixed costs of development and the scarcity of funding sources made it economically infeasible to rehabilitate small multifamily buildings.

THE SOLUTION:

Cleveland Housing Partnership's commitment to the importance of revitalizing these properties, combined with the creativity and sheer determination of local nonprofits to assemble several small buildings into one financing package provided the key to this intractable problem.

In the first Cleveland Multifamily Limited Partnership project, the Broadway Area Housing Coalition, Union-Miles Development Corporation and the Cleveland Housing Network joined together to form a limited partnership to renovate five small, deteriorating apartment buildings that were problem properties for the neighborhood.

The partnership assembled five multifamily buildings scattered throughout three neighborhoods into a single rehab project of 31 units. The size of the project enabled the partnership to achieve the needed economies of scale.

Each housing group assumed responsibility for the development and property management tasks for the buildings in its neighborhoods. The Network packaged the project financing and assumed certain development tasks. The total development cost of the project was $1.1 million.

The project was completed successfully and the model was replicated the following year with Cleveland Multifamily Limited Partnership II, a project with 41 housing units and 2 commercial units in 5 Cleveland neighborhoods. The total development cost of the second project was $1.4 million.

The Cleveland Housing Partnership Equity Fund made equity investments totalling $1 million in the two projects. Additional financing was provided by The Enterprise Foundation, the City of Cleveland, the State of Ohio, the Local Initiatives Support Corporation, Society Bank, Bank One, Cleveland NA and First Nationwide Bank.

THE IMPACT:

With the financial support of the Cleveland Housing Partnership, Cleveland nonprofit developers have created a successful vehicle for the cost-effective development of small apartment buildings in critical locations in their neighborhoods.

Multifamily Housing: Better Options

The Molinas chose to stay in Cleveland to be close to expert medical care for their youngest son.

The Molina family has moved many times since they arrived in the United States from the Dominican Republic seven years ago. Since they moved to Cleveland two years ago, they have rented two apartments and moved each time — once due to mouse and roach infestations, and once because the house was sold.

The Molinas, however, chose to stay in Cleveland to be close to expert medical care for their youngest son, who was born with heart defects and has had two open heart surgeries, one at The Cleveland Clinic.

A property manager referred Maria Molina to the four suite apartment complex on West 45th Street, rehabilitated by the Near West Housing Corporation, a member of the Cleveland Housing Network, and financed as part of the Cleveland Multifamily I package.

They now live in a spacious 3-bedroom apartment with attic space on the third floor, and pay the same rent, $250 per month, which they had paid for a 2-bedroom unit. Mr. Molina is particularly impressed with the energy-efficiency of the apartment — they pay only $57 monthly in heating expenses compared to $140 - $150 per month at their last apartment.

Both the Molinas have passed the examination to become American citizens and plan to make Cleveland their home. They are anxious to be sworn in and be able to vote — and they are also looking forward to renewing the lease on their new home.

Gordon Square Arcade:

Rebuilding Neighborhoods Through Landmark Projects

The Challenge:

Large multi-use development projects of scale are rarely undertaken in Cleveland neighborhoods because of high rehab costs and uncertain market demands. But the restoration of a large landmark building can be critical to the revitalization of an entire neighborhood.

THE SOLUTION:

The redevelopment of the Gordon Square Arcade in the Detroit-Shoreway neighborhood is the best recent example of a community organization persevering to restore a local landmark and revitalize a neighborhood.

By the mid-1980's, the 144,000 square-foot Gordon Square Arcade had deteriorated to be of very limited economic use to the surrounding community. Retail and office tenants had left for better space in the suburbs. A single-room occupancy residence hotel was poorly maintained and produced little income.

In 1988, the Detroit-Shoreway Community Development Organization (DSCDO) determined that the best plan to redevelop and stabilize the Arcade was to convert the under-utilized residential and office space to low-income housing for the elderly and handicapped in the neighborhood. Working with The Enterprise Foundation, DSCDO assembled a partnership including John Ferchill, a prominent private developer, to undertake the redevelopment. A complex financing package was devised. Two Cleveland corporations - BP America and BankOne - made a $1.4 million equity investment in the project. $2.5 million in permanent financing was secured through a mortgage banker. Additional financing was provided by the City of Cleveland, the State of Ohio and local and national foundations. Federal rent subsidies were provided through the Cleveland Metropolitan Housing Authority.

Construction on the Gordon Square Arcade was completed in 1989. It now offers 64 apartments for the elderly and handicapped, a modern office incubator and fully leased retail space. With the renovation of the Arcade, other merchants and property owners in the surrounding area are joining the revitalization effort by making improvements to their properties.

THE IMPACT:

The rebuilding of the Gordon Square Arcade stands as a tribute to the determination of DSCDO and the support of many participants, including Cleveland Housing Partnership corporations. It serves as a visible model for future projects undertaken to spur the redevelopment of Cleveland neighborhoods

Life in the New Gordon Square Arcade

> **"I just couldn't believe my eyes," she said, of the modern one-bedroom apartment she now calls home.**

Frances Farina had her doubts. For most of the years she lived in her dilapidated efficiency apartment with a shared bath in the Gordon Square Arcade, Frances had heard rumors about a planned renovation of the building. In April 1988, those rumors proved true.

Frances and 40 other tenants living in the Arcade's residence hotel were temporarily relocated to nearby apartments. During the time of the relocation, the building tenants regularly returned to the Gordon Square Arcade to talk with the project manager, pick up their mail and check on the construction progress. Finally, in November, Frances had an opportunity to see her new apartment.

"I just couldn't believe my eyes," she said, of the modern one-bedroom apartment she now calls home. "I even have an extra little room to use as a sewing room," she explained, referring to what would have been wasted space behind an abandoned stairwell wisely incorporated into the unit's floor plan.

Frances enjoys, as do the other longtime Gordon Square Arcade tenants, having her own locked mailbox, secure building entrance with intercom and access to the interior of the arcade from which she can enter several retail establishments.

Project Investments

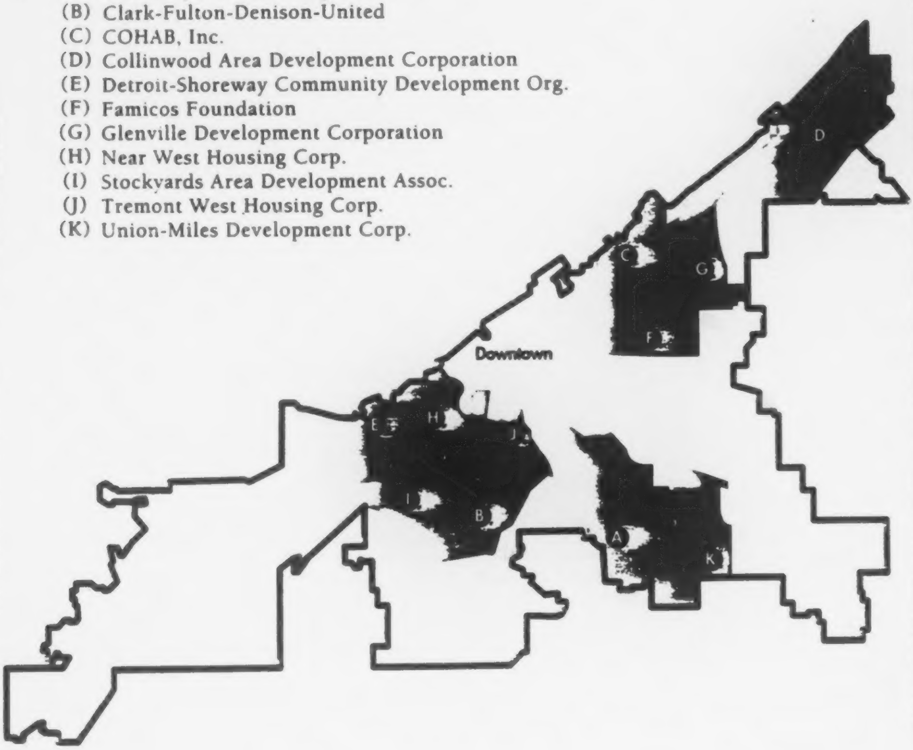
PROJECT/DEVELOPER	TYPE OF PROJECT	DATE
CHNLP I Cleveland Housing Network	19 unit, scattered-site, single-family rehab; nine CHN neighborhoods	1986
CHNLP II Cleveland Housing Network	25 unit, scattered-site, single-family rehab; nine CHN neighborhoods	1986
CHNLP III Cleveland Housing Network	40 unit, scattered-site, single-family rehab; nine CHN neighborhoods	1987
CHNLP IV Cleveland Housing Network	40 unit, scattered-site, single-family rehab; nine CHN neighborhoods	1988
6516 Detroit Associates LP John Ferchill and Detroit-Shoreway Community Development Organization	64 unit, mixed-use rehab for elderly and handicapped; Detroit-Shoreway neighborhood	1988
CHNLP V Cleveland Housing Network	80 unit, scattered-site, single-family rehab; nine CHN neighborhoods	1988
CMFLP I Union-Miles Development Corporation; Near West Housing Corporation; Broadway Area Housing Coalition; Cleveland Housing Network	31 scattered-site, small multifamily rehab;Union-Miles, Near West and Broadway neighborhoods	1988
LEXINGTON VILLAGE II McCormack, Baron and Associates and Famicos Foundation	94 unit townhouse, new construction Hough neighborhood*	1989
CMFLP II Broadway Area Housing Coalition, Union-Miles Development Corporation; Tremont West Development Corporation; Glenville Development Corporation; Cleveland Housing Network	41 unit, scattered-site, small multi-family rehab, Broadway, Union-Miles, Tremont and Glenville neighborhoods	1989
CHNLP VI Cleveland Housing Network	80 unit, scattered-site, single family rehab; eleven CHN neighborhoods	1990
TOTAL PROJECTS 10	**TOTAL UNITS 515**	

** Ten Cleveland corporations made a 1.6 million investment; CHPEF purchased 3% of the equity to complete the financing*

Neighborhoods and Community Development Corporations Which Have Received Support from the Cleveland Housing Partnership

While the Fund may make investments throughout the Cleveland area, there is a preference for projects in the City of Cleveland.

(A) Broadway Area Housing Coalition
(B) Clark-Fulton-Denison-United
(C) COHAB, Inc.
(D) Collinwood Area Development Corporation
(E) Detroit-Shoreway Community Development Org.
(F) Famicos Foundation
(G) Glenville Development Corporation
(H) Near West Housing Corp.
(I) Stockyards Area Development Assoc.
(J) Tremont West Housing Corp.
(K) Union-Miles Development Corp.



Corporate Investors

BP America Inc.
Banc One Community Development Corporation
Bearings, Inc.
Eaton Corporation
Ferro Corporation
First Financial Services Development Corp.
Forest City Enterprises
The Higbee Company
Huntington Bancshares Incorporated
MTD Products, Inc.
NACCO Industries, Inc.
National City Community Development Corp.
Nestle Enterprises, Inc.
Parker Hannifin Corporation
Premier Industrial Corporation
The Sherwin-Williams Company
Society National Bank
The Standard Products Company
The Stouffer Corporation
Sunarhauserman Inc.
TRW Inc.

Partners, Supporters and Funders

DEVELOPERS

Cleveland CDC's
and Private Developers

INVESTORS

Cleveland Corporations

NET WORTH GUARANTOR

East Ohio Gas Company

FUND MANAGEMENT

Cleveland Housing Partnership, Inc. with management support provided by Enterprise Social Investment Corporation

TECHNICAL SUPPORT

The Enterprise Foundation

FUND ACCOUNTANTS

Ernst & Young, Cleveland

FUND ATTORNEYS

Calfee, Halter &Griswold, Cleveland
Ginsburg, Feldman & Bress, Washington, D.C.

SUPPORTERS, FUNDERS AND LENDERS

BP America
Cleveland Tomorrow
Ohio Bell
Centerior Energy Corp.
The Cleveland Plain Dealer
The Enterprise Foundation
City of Cleveland
Ameritrust Development Bank
First Nationwide Bank
Society National Bank
Cleveland Metropolitan Housing Authority
Bank One, Cleveland, NA
Ohio Housing Finance Agency
State of Ohio, Dept. of Development
Cleveland Housing Network
Gund Foundation
Cleveland Foundation
Neighborhood Progress, Inc.
Center for Neighborhood Development
Local Initiatives Support Corporation
National Trust for Historic Preservation

Demographic Profile

Tenant Households

AVERAGE HOUSEHOLD SIZE	**3 persons**
HEAD OF HOUSEHOLD	**26% male** **74% female**
RACE	**19% hispanic** **58% black** **23% white**
AVERAGE ANNUAL HOUSEHOLD INCOME	**$7,045**
MAIN HOUSEHOLD INCOME SOURCE	**35% employment** **65% public assistance**

* *Information compiled in April, 1989 on 204 households presently living in units developed under Cleveland Housing Network Limited Partnerships I-V.*

Additional Information

Requests for additional information about the Cleveland Housing Partnership Equity Fund can be directed to:

The Enterprise Foundation

6516 Detroit Avenue, Suite 5
Cleveland, Ohio 44102

216/651-4777

The Enterprise Social Investment Corporation

502 American City Building
Columbia, MD 21044

301/964-0552

4-26-90

TESTIMONY OF JOHN C. WEICHER
ASSISTANT SECRETARY FOR POLICY DEVELOPMENT AND RESEARCH
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
BEFORE THE HUD/MOD REHAB INVESTIGATION SUBCOMMITTEE OF THE SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
APRIL 27, 1990

Mr. Chairman, Members of the Committee.

I am pleased to be able to discuss the low income housing tax credit with you and other members of the panel today. In my remarks, I will emphasize the relationship of the housing credit to the mission of the Department of Housing and Urban Development and to the Department's programs. In particular, I will explain the Secretary's REFORM initiative to ensure that the use of the housing credit with HUD programs does not lead to an excessive layering of subsidies. I am accompanied this morning by James Logue, HUD's Deputy Assistant Secretary for Multifamily Housing. Jim has been the architect of HUD's efforts to solve the subsidy layering problem. Finally, I will also describe the efforts of my Office to monitor and evaluate the credit and provide you with some findings from our monitoring activity.

The Housing Credit and Housing Policy

Secretary Kemp is a strong supporter of the low income housing tax credit. The President's HOPE proposal calls for extending the housing credit for an additional year and for fully funding the credit in 1990.

The Secretary believes that the housing credit is a significant improvement over previous tax incentives for rental housing for three of reasons. First, the credit goes only to units serving low income families so there is a direct incentive to serve these households. Second, the definition of low-income ensures that the incentive is directed to those most in need. Third, the statutory limits on allowable rents ensure that low income families benefit from the credit. These design features make the low income housing tax credit, in effect, a new housing assistance program.

The housing credit has other advantages which also recommend its continuation. States are given the authority to allocate credits to their most important needs, and the program encourages the participation of non-profits. The Secretary believes that the housing credit can form the basis for creative efforts which link rental housing assistance to eventual ownership of the project by the tenants, and he was pleased by changes in last years Reconciliation Bill which facilitate these efforts.

In 1989 the States allocated $307 million in housing credits. This is the equivalent in budget terms of more than $3 billion in budget authority for housing assistance. When added to the budget authority in 1989 for assisted housing, this represented an increase in Federal resources of almost 40 percent. Clearly, the housing credit substantially augments the resources available for dealing with the Nation's housing problems. In its first three years, the credit supported the construction of 111,000 units and the rehabilitation of another 95,000 units.

The Housing Credit and HUD Programs

The housing credit interacts with HUD's housing assistance programs in a number of important ways. Through new construction and substantial rehabilitation, the housing credit expands the stock of housing available to holders of housing vouchers and Section 8 certificates. At the same time, vouchers and certificates allow families with very low income to afford housing credit units whose rents are not designed to be affordable by families with incomes substantially lower than 50 percent of median income.

The versatility of the housing credit potentially makes it an additional tool for assisting in the resolution of the prepayment problem. For the past few years, both Congress and the Department have been concerned that a sizeable number of existing assisted housing units will be converted to higher income use through prepayment. The Administration has proposed a three-pronged preservation strategy, aimed at homeownership, as part of the HOPE initiative. If enacted, HUD would provide over $1 billion in assistance over 3 years that would in part help resident groups in Federally insured and subsidized multifamily projects purchase their buildings and become homeowners when an existing owner chooses to prepay his mortgage. Nonprofit neighborhood groups working on behalf of resident councils are also eligible for these grants. While HOPE is designed primarily to encourage homeownership, the housing credit could be used to help avert prepayments in situations where conversion to homeownership is not immediately feasible.

In 1989, Senators Mitchell and Danforth and Congressman Rangel sponsored a change to the low income housing credit which will strengthen our ability to address the prepayment issue. This change expands the waiver of the 10-year placed-in-service requirement to avert prepayment. If a State recognizes that prepayment would cause serious local hardships in a particular case, the State could allocate the housing credit to a new owner and thereby raise the sales price received by the existing owner. Combined with other resources, the housing credit can provide the compensation to which current owners believe they are entitled and the support which new owners will need to maintain the low income character of the project and, perhaps, support the eventual conversion of the project to tenant ownership. The Department welcomed this change and will work with States to use the tax credit with other resources at HUD's disposal, particularly the HOPE initiative, to maintain the stock of assisted housing.

The ability to waive the 10-year placed-in-service requirement for financially distressed projects has also been important to HUD. The Department has found that often both a change in management and an influx of new capital are need to resolve the financial problems of insured, assisted housing projects. The housing credit can both facilitate the sale of a troubled project and provide the source of returns needed for new owners to invest new capital. In many cases, new owners could not claim the credit without the waiver of the 10-year placed-in-service rule.

The Housing Credit and the Section 8 Moderate Rehabilitation Program

Finally, the housing credit has been used in conjunction with project-based HUD housing assistance, most typically, with the

Section 8 Moderate Rehabilitation Program. Our estimates indicate that 224 Mod Rehab projects with over 12,000 units received housing credit allocations in 1987 and 1988. The changes in the 1989 Budget Reconciliation Act prohibit use of the housing credit with Section 8 mod rehab assistance.

The combination of housing credits and Section 8 mod rehab provided certain housing policy benefits, namely, making some risky projects financially feasible and enabling the housing credit to serve the very low income families typically served by Section 8 mod rehab. However, in some cases, the combination of subsidies provided such high returns to investors that extraordinary efforts were made to obtain the Section 8 assistance -- efforts which, at best, could be characterized as questionable and, at worst, as dishonest.

It is commonly believed that the excessive layering of subsidies is a problem principally of Section 8 mod rehab. However, the problem is potentially broader than mod rehab. Using housing credits in a work-out of a troubled assisted housing project or in a prepayment work-out or in any situation where there are other Federal, State, or local subsidies can also lead to excessive layering of subsidies.

Secretary Kemp, recognizing the seriousness of this issue, made elimination of excess subsidies a major element in the REFORM proposal he announced last October. HR 1, the HUD REFORM legislation, contains the Secretary's recommendation.

Because of the importance we give to this matter at HUD, I am going to devote a substantial portion of my testimony to describing how HUD plans to eliminate the excessive layering of subsidies.

The Housing Credit and REFORM

The REFORM legislation establishes the framework necessary to eliminate the excessive layering of subsidies.

> Section 102(d) requires the Secretary to "certify that assistance within the jurisdiction of the Department to any housing project shall not be more than is necessary to provide affordable housing after taking into account of other government assistance." Other government assistance includes low income housing tax credits and other Federal tax benefits as well as State and local assistance.
>
> Sections 102(b) and (c) authorize the Secretary to require the disclosure of any relevant assistance from other sources in considering any application for HUD assistance.

Implementing this framework is a very complicated task. Many participants are involved in the development of a successful assisted housing project; these include: the seller (in the case of a troubled project or a prepayment), the developer or sponsor, the syndicator, and the investor. Multiple subsidies can generate excessive returns for any one of these participants. However, if one participant fails to earn a sufficient rate of return, the assisted project cannot be developed. The REFORM mandate requires HUD to ensure that each participant receives a sufficient but not unnecessarily high return from the project.

To help carry out this difficult assignment, HUD enlisted the assistance of the accounting firm of Arthur Andersen & Co. The staff at Arthur Andersen has worked with HUD staff to study how HUD interacts with each participant, to determine whether existing HUD controls are sufficient for each participant, and, if not, to modify the existing controls or develop new ones.

In direct response to the requirements of Section 102 of HR 1, we have determined, after several months of work, that HUD controls are sufficient or can easily be made sufficient for the seller and the developer or sponsor. However, the housing credit has added a new dimension to the development of assisted housing projects and we have concluded that existing HUD controls do not adequately deal with the returns to syndicators and investors. With Arthur Andersen's help, HUD is developing new controls designed to prevent higher than necessary rates of return for these participants while still permitting the rate of return necessary for the project to be successful.

HUD is now in the process of finalizing the techniques for carrying out the Section 102 mandate and is preparing to implement them in conjunction with the regulatory process. While the new techniques incorporate the sophistication of a careful accounting analysis, they are based on simple common sense principles -- namely, HUD needs to look at all the assistance being received and must either constrain its own support or find other ways to balance assistance from other sources. These common sense principles are guides which HUD has endeavored to follow, without the aid of sophisticated models, in all transactions involving the housing credit since Secretary Kemp took over his responsibilities at the Department.

Section 102 places a requirement on HUD very similar to the new requirement which last year's changes to the housing credit placed on the States. The Reconciliation Bill amended the Internal Revenue Code to require States to determine that "the housing credit dollar amount allocated to a project shall not exceed the amount ... necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period." As part of this determination process, applicants for credits must reveal to "the housing credit agency the full extent of all Federal, State, and local subsidies" received. (Section 42(m)(2) of the IRC)

HUD and the State agencies have recognized our common interest in developing techniques for distinguishing between a necessary level of subsidization and too much subsidization. We have discussed this problems at length and have shared information freely. We will continue to work together and share our methodology with the State agencies.

In addition, the Department stayed in constant contact with the State agencies as they developed their allocation plans. Our Field Offices have met with each State agency to discuss their allocation plans and to establish a channel for sharing information. It is the Department's intent to work in full cooperation with the National Council of State Housing Agencies and its individual members to assure full cooperation in allocating Federal, State and local housing resources.

Jim Logue will be glad to answer any of your questions.

Monitoring and Evaluation

HUD has many reasons for being interested in how well the low income housing tax credit has been working. The Department recognized these interests early on and started an active monitoring and evaluation effort related to the housing credit.

On the monitoring side, HUD funded the National Council of State Housing Agencies (NCSHA) to collect data from the State allocating agencies on individual projects receiving allocations. Not all States responded to the NCSHA request for data on individual projects, not from a lack of cooperation but from lack of staff or restrictions imposed by State privacy act laws. However, NCSHA did obtain data from 46 States and the District of Columbia in 1987 and 46 States, the District of Columbia, Puerto Rico, and the Virgin Islands in 1988. 45 States and the District of Columbia reported in both years. NCSHA is currently collecting project-level data on 1989 allocations and HUD is planning to continue this monitoring effort through 1990.

These data provide a more in-depth description of how the housing credit is being used although it is important to realize that the data have limitations. First, not all States have responded. Second, because of the pressures involved in completing allocations within the statutory period, it was often impossible for States to check thoroughly the data submitted to NCSHA. Therefore, there can be errors in the description of particular projects. Still this information is the fullest available and we have attempted to weed out results which we believe are questionable. I am glad to share some results from our analysis of this data with the Committee.

First, however, I will present overview information NCSHA collected independent of the HUD contract. NCSHA tells us that the States allocated only 18% of the available credits in 1987, a learning period; 67% in 1988 (helped in part by the carry-over provision passed that year); and 98% in 1989.

HUD's analysis of the NCSHA data shows that the housing credit was used in a wide variety of applications. The numbers reported below are from 1988 allocations, a year HUD believes is more typical of the program than 1987.

> The housing credit was used for new construction (45% of the units), substantial rehabilitation (23%), acquisition combined with substantial rehabilitation (18%), and acquisition only (13%). Of course, the 1989 changes to the housing credit eliminated the acquisition only option.
>
> The average credit allocation for a newly built unit was $2,800. It was $2,400 for a substantially rehabilitated unit; $1,850 for an acquisition combined with rehab; and $1,400 for an acquisition only.
>
> The housing credit was used mainly in conjunction with other subsidies (72% of the units) but use without other subsidies was frequent (28%).
>
> Developers frequently combined the housing credit with FmHA assistance (29% of the units).
>
> 70% of the units were located in metropolitan areas, 30% outside of metropolitan areas. This represents a higher concentration outside of metropolitan areas than the total rental stock, where 83% is in metropolitan areas and 17% is outside of metropolitan areas.
>
> Family size units predominated with 55% of the units having 2 or more bedrooms; 13% with 3 or more bedrooms. For all new multifamily units completed in 1988, 2 plus bedrooms accounted for 63% and 3 plus bedrooms accounted for 8%.
>
> The size distribution of buildings demonstrates vividly how flexible the housing credit is. 27% of the buildings had only one unit; 55% had 4 or fewer units. At the other end of the distribution, there were 5 projects with over 500 units and 185 with between 100 and 499 units. (The comparable numbers for the total rental stock are 26% in single detached units and 58% in buildings with 4 or fewer units.)
>
> Because investors receive credits only for units meeting program requirements, projects typically contain mainly units meeting program requirements. 92% of the projects have 100% of their units receiving credits; only 3% of the projects

have less than 60% of their units receiving credits. Eliminating small buildings, those with 4 or fewer units, changes the numbers to 88% and 6% respectively.

Non-profit sponsors accounted for 11% of the units.

When HUD compared the usage for States which reported in both 1987 and 1988, only a few differences appeared.

One important change was a decline in the proportion of Section 8 Mod Rehab units (from 15% of units to 8%). However, the actual number of units was slightly larger because allocations increased almost fourfold between the two years.

While this information gives a more detailed picture of what types of housing the credit is funding, it does not answer the more fundamental question of how well this program is achieving its intended purpose. For this reason, HUD is funding a separate evaluation of the housing credit.

The overall objective of the evaluation is to assess the effectiveness of the housing credit and to evaluate its role in national housing policy. To achieve this objective, the evaluation attempts to answer the following questions:

What types of projects use the LIHTC? What other subsidies are used in these projects? What types of market are served?

What are the characteristics of tenants residing in tax credit properties? Do tax credit units serve the same income groups as other federal programs or are incomes close to the area maximums established under the program? Are tax credit units affordable to their low-income tenants?

What is the financial structure of LIHTC projects? How much equity is raised as a result of the credit and what are the transaction costs?

What returns are LIHTC projects expected to earn? Is the credit necessary or would the projects have been developed in its absence?

> What are the costs of developing LIHTC projects? Is the program cost effective as compared to other approaches to subsidizing low-income housing?

The study draws on data from two principal sources. The first is the national data base describing the universe of LIHTC projects developed in 1987 and 1988 assembled by the National Council of State Housing Agencies. The second source of data is an in-depth survey of tax credit developers conducted specifically for this study. This survey produced detailed financial data on 104 properties which received credits in 1987 or 1988. Information obtained through the survey includes data on the sources and uses of funds for project development as well as other financial and tax parameters needed to estimate returns to investors in tax credit properties. In addition, the survey collected household data for tenants in a sample of units in each property.

ICF, Incorporated, is the prime contractor for the evaluation; the accounting firm of Price-Waterhouse is the subcontractor with responsibility for modeling the financial aspects of the low income housing tax credit projects in the sample. The Department recently received a draft report from ICF and is currently reviewing the report. At the beginning of this evaluation, HUD asked ICF to set up a review panel consisting of syndicators, developers, representatives of the States, and others interested in the credit. Once HUD is finished reviewing the report, ICF will reconvene the panel for a further review of the report. As a consequence of this multistage review process, ICF will make changes and present HUD with a final report. I will be glad to share that report with the Committee as soon as it is finished.

I believe that HUD's monitoring and evaluation efforts with respect to the low income tax credit will benefit greatly all parties interested in the housing credit and housing policy in general.

Testimony Before
the Senate Committee on Banking, Housing and Urban Affairs
HUD/Mod Rehab Investigation Subcommittee
By Mark Hendrickson,
Executive Director, Florida Housing Finance Agency
On behalf of the
National Council of State Housing Agencies

April 27, 1990

Mr. Chairman and Members of the Subcommittee, my name is Mark Hendrickson and I am Executive Director of the Florida Housing Finance Agency. I am here this morning representing the National Council of State Housing Agencies (NCSHA). Thank you for the opportunity to appear before you to discuss the Low Income Housing Tax Credit ("The Tax Credit"). The Tax Credit is administered in nearly every state by the State Housing Finance Agencies (HFAs) which are the members of NCSHA.

NCSHA is a national, not-for-profit organization created in 1970 to represent the interests of State HFAs in low and moderate income housing. HFAs in every state, the District of Columbia, Puerto Rico, and the Virgin Islands respond to low and moderate income housing needs through the financing, development, and preservation of affordable rental and ownership housing. HFAs collectively operate more than 350 affordable housing programs, which range from homeownership to homeless initiatives.

State HFAs have helped more than one million low and moderate income Americans buy their first home and have financed over 500,000 units of rental housing for low and moderate income tenants through reduced rate mortgages financed by tax exempt bonds. Since 1986, HFAs have financed 235,000 low income apartments through the Tax Credit for households with incomes of 60 percent of area median income or less.

The Tax Credit is the single, major federal incentive available for the production and rehabilitation of low income housing. Yet it is scheduled to expire this year. Congress must act to extend it, hopefully on a permanent basis. For many of the poorest Americans, the gap is growing between available income and the cost of decent housing. At the same time, units are being lost from the affordable housing inventory. The Joint Center for Housing Studies at Harvard University reported last year that despite the build-up of subsidized housing from 1974 to to 1985, the number of occupied units renting at or below $300 per month in constant dollars fell by 1.7 million. The number of non-subsidized units renting for less than $300 fell by 2.8 million, a decline of nearly one-third.

Last year the Senate Finance Committee unanimously recommended a permanent extension of the Tax Credit program as proposed in S. 980, legislation introduced by Senators Mitchell (D-ME) and Danforth (R-MO) and co-sponsored by 72 Senators. In the Budget Reconciliation compromise, the extension was shortened to one year through December, 1990.

Many members of this Subcommittee, including you, Mr. Chairman, have co-sponsored the Mitchell-Danforth legislation, as well as the National Affordable Housing Act, S. 565, which also calls for permanent extension of the Tax Credit program. We thank you for your support and ask for your help in securing a permanent extension this year.

In the Tax Credit program extension last year, the Congress included several program reforms, many of which were first advanced by NCSHA. These improvements, particularly the increased responsibility for credit allocation and project evaluation granted State HFAs, will increase efficient use of the Tax Credit. The requirement for rationing multiple federal subsidies contained in the Department of Housing and Urban Development Reform Act of 1989, H.R. 1 will also stretch available subsidy dollars.

To a large extent, however, these and other program changes Congress enacted last fall also render existing Tax Credit data obsolete as a basis for judging the future of the program. The reforms NCSHA sponsored and Congress enacted last fall were meant to address and reform the very shortcomings that data revealed. With that background, the following are our comments on the specific issues you asked us to address.

What Data is Now Available Regarding the Use of the Tax Credit?

The NCSHA is the principal collector and repository of data on the Tax Credit through surveys of the state agencies which allocate it. The results of the 1987 and 1988 surveys have been shared with the Subcommittee staff and with the General Accounting Office (GAO). Data on 1989 projects is currently being compiled and will be available in June. From all the available data, we have learned the following:

- **The targeted tenant population is benefiting from the program.** The Tax Credit has produced 235,917 units of low income rental housing in only three years, 1987 through 1989. The 124,518 low income units produced in 1989 - a level we believe will be sustained in future years - compares with 158,000 units produced under the Section 8 New Construction and Substantial Rehabilitation program, the nation's chief means of producing low income housing before the Tax Credit, during 1978, the peak year of production under the program. In 1987, 90 percent of all the units in Tax Credit projects were set aside for low income use. This percentage declined to 85 percent in 1988, but climbed to 93 percent in 1989. The Tax Credit is not available to non-set-aside units in these projects.

- **Most states are fully using their annual Tax Credit allocation**. Federal law limits the Tax Credit to $1.25 per capita per state, or about $300 million nationwide per year. In 1989, states allocated nearly 100 percent of their available Tax Credits, compared to 19 percent in 1987 and 68 percent in 1988, during the start-up phase of the program.

- **Projects are generally small.** The average size of 1988 Tax Credit projects was 25 units in 1987, 30 in 1988, and 36 units in 1989.

- **Strong Activity Outside Metropolitan Statistical Areas.** Although only 22 percent of all occupied housing is located outside of Metropolitan Statistical Areas (MSAs), 30 percent of Credit projects were located outside MSAs in 1988 and 1989.

- **The Tax Credit alone is not sufficient to ensure development feasibility.** In most cases, the Tax Credit alone does not provide a sufficient subsidy to make a qualifying low income project economically viable. Hence, in most cases, some other subsidy must be added to the use of the Tax Credit to make the project work. In 1987 and 1988 three-fourths or more of Tax Credit projects relied on some type of federal, state, or local subsidy in addition to the Tax Credit, although only five percent received Section 8 Mod Rehab. We expect that when the Tax Credit statistics for 1989 are available, they will show that the number of projects receiving Mod Rehab declined significantly.

- **The use of the Tax Credit to simply acquire projects is declining and the amount of new construction is increasing.** Use of the Tax Credit for acquisition of existing projects for low income use has declined from 17 percent in 1987 to 11 percent in 1989. We expect the trend away from acquisition to accelerate under the new Tax Credit law, because it does not permit the Tax Credit to be used for project acquisitions without a minimum of $3,000 per unit in rehabilitation costs. Between 1987 and 1989, Tax Credit financed new construction increased from 43 percent to 50 percent.

- **Nonprofit sponsorship increased.** Tax Credit dollars allocated to nonprofit-sponsored developments of available Tax Credit dollars increased from 7 percent in 1987 to 16 percent in 1989.

How Can Net Capital Invested in Low Income Housing With the Inducement of the Tax Credit be Maximized?

State HFAs are anxious to help assure the creation of more cash equity for each dollar of Tax Credit allocated.

Three developments will increase the number of units the Tax Credit can finance:

- In the 1989 program revisions, Congress authorized the states to do project-by-project evaluations of Tax Credit applicants and to limit the amount of credit allocated to a project to the amount necessary to assure its economic feasibility and viability.
- In H.R.1, Congress mandated state Tax Credit allocating agencies and HUD to ration the total amount of subsidy in any project to assure that unnecessary subsidies are not provided to a project and that the maximum possible number of units are created from the existing subsidy dollars.
- Nonprofit syndication funds, such as those sponsored by LISC and the Enterprise Foundation and underway or planned by several states, reduce the cost of syndicating the Tax Credit substantially in comparison to private funds, thus providing more equity for the amount of Credit sold.

The effect of the project evaluation process in the Tax Credit extension and the subsidy comparison process in H.R.1 should be to ration the amount of credit reaching any individual project to the lowest feasible amount. That process should have the effect of forcing developers and syndicators of the Tax Credit to make the most efficient use of the Tax Credit allocated to a project by wringing the maximum number of investor dollars possible out of the sale of those credits.

Reducing syndicator costs through increased use of nonprofit and state-sponsored funds will also cut the overhead in raising capital through the Tax Credit, thereby increasing the net capital invested in Tax Credit projects. The overhead cost of a state-sponsored fund in Rhode Island, for example, is 14 percent, compared to the average 26.5 percent cost GAO found in a study of syndicator costs last year.

The number of private placements of the Tax Credit with corporations, which do not involve the costs of SEC registration and marketing required in public funds, has also increased during the past two years and is providing as much as a third or more of all Tax Credit proceeds. Given the likely demand for the Tax Credit, privately syndicated offerings of Tax Credits to the general public will continue to be a major source of Credit funding for the foreseeable future. Competition from lower overhead nonprofits and state-sponsored funds will, however, exert pressure on the private syndications to keep their overhead as low as possible, since developers who show greater investment in the project from their proposed Tax Credit allocation will have an advantage in the project allocation and evaluation process.

We must recognize, however, that the long-standing and appropriate policy of the federal government in housing assistance has been to rely on the private sector for financing and production. The Tax Credit is designed to attract investor dollars with tax breaks. Investors will compare the actual rate of return from Tax Credit purchases with the rates of return on alternative investments. In that context, the GAO's estimate that Tax Credit investors are demanding a 12 to 13 percent return on Tax Credit investments may be more surprising for its modesty than for its size.

Investors in the Tax Credit are taking risks in low income real estate for the next 15 years or more which include little likelihood of a positive cash flow from the project, the potential for tax liabilities for noncompliance with the Tax Credit, and potential inability to recover all of the initial investment when the project is finally sold.

Attractive investment alternatives are available to these same investors. According to last Sunday's *New York Times*, these same investors could have earned a return ranging from 10 percent to 12.2 percent last year from investment in any four of five of the largest government bond mutual funds, including several funds whose holdings are guaranteed by the federal government. During the previous five years, four of these five publicly available mutual funds provided comparable returns. Even after two market crashes, the Standard and Poor's stock market average shows a 20 percent rate of return for the same five years, a figure that a number of mutual funds have exceeded. The return demanded by investors for Tax Credit projects must therefore be judged in comparison to real investment alternatives, not in the abstract.

Likewise, the economic efficiency of the Tax Credit itself must be judged against realistic alternatives. It replaced a system of accelerated depreciation and other tax incentives for low income housing development which may not have been more efficient. Although I am not aware of any study which compares the efficiency of the Low Income Tax Credit to the federal incentives it replaced, the percentage of actual dollars invested in housing in prominent public syndications which preceded the Tax Credit appear, to be no greater than many of the cases the GAO has examined.

Nor is enactment of a new direct federal subsidy for the construction of the units the Tax Credit now finances likely in a Gramm-Rudman era, especially when the Administration opposes such a production program. The amount of federal assistance to housing has been slashed dramatically since the $32 billion a year level of 1978. The Senate Budget Committee has estimated that this year's HUD budget actually proposes cutting the federal level of effort by 20 percent during the next five years.

The Tax Credit is, in short, our only reasonable alternative for the production of low income housing production. While we are all committed to its improvement and maximum feasible efficiency, its performance should be compared to realistic investor and federal alternatives.

How are the HFAs and HUD Implementing the 1989 Changes in the Law which Require that the Tax Credit Subsidy and HUD's Non-Tax Subsidies be Provided in an Efficient Manner that Takes into Account the Availability of Each Type of Subsidy?

The new Tax Credit law requires state HFAs to target, through state-wide allocation plans, projects which meet the states' housing needs and priorities, especially the needs of the lowest income tenants, and to award only the amount of Tax Credit absolutely necessary to assure a project's financial feasibility and long-term viability.

NCSHA and its member HFAs helped design this new process long before the HUD scandals last year. We recognized that demand for Tax Credits would soon outstrip supply and were clear on the rationing role that State HFAs should play in this new era.

As of this date, twenty-six state HFAs have already received gubernatorial approval of their Tax Credit allocation plans and have begun accepting applications for the 1990 program. The others expect approval of their draft plans within the next few weeks. The public has been deeply involved in the development of these plans through hearings which have been well attended in every state. A copy of the Tax Credit Application prepared by NCSHA and in common use among the states, which shows the data upon which the Tax Credit allocation and project evalusation is based, is included as Appendix A to this testimony

In preparing these plans, each State HFA conducted a state-wide housing needs assessment, analyzing the current housing situation and future needs, including rural housing, low income counties, high-growth counties, inner cities, family housing, special needs tenants, and the preservation of existing affordable housing.

Although the project selection process varies somewhat from state to state, a basic pattern has emerged. Some plans define threshold criteria which a project must meet in order to qualify for the Tax Credit. Most states developed a point system to rank the eligible applications received during a funding cycle. Highest ranking projects receive commitments for Tax Credit dollar amounts based upon preliminary evaluations. When a project is placed in service, the project is evaluated again and the actual Tax Credit amount allocated.

Florida already had experience selecting projects under its SAIL program, which provides state assistance to low income rental projects. The selection criteria employed under our allocation plan reflect the process we have used selecting projects under the SAIL program.

H.R. 1 imposed responsibilities on both HUD and FmHA for their subsidy programs similar to those HFAs have in the Tax Credit process. Special scrutiny is required where HUD or FmHA subsidies are combined with the Tax Credit.

We are working with HUD to ensure that our responsibilities under the Tax Credit legislation are synchronized with the regulations they will promulgate pursuant to H.R. 1. We have asked to meet with them shortly, as soon as their preliminary work is completed. We want the most simple and understandable process consistent with getting the most "bang for the buck" in the case of every direct subsidy and Tax Credit given to any project.

NCSHA has also met with the FmHA to discuss our respective responsibilities. We are working to clarify the steps an applicant seeking both FmHA and Credit subsidies must take. We are also working to facilitate the flow of information between the two agencies about projects which have applied for assistance from both.

What Methods and Resources are State Housing Agencies and the Internal Revenue Service Likely to be Able to Employ to Monitor and Enforce Compliance with the Tax Credit Requirements?

Although heavy tax penalties apply to investors in Tax Credit noncompliance cases, compliance is now largely a matter between the taxpayer and the Internal Revenue Service. The investor must annually provide the Service with prescribed forms to provide evidence of compliance with the Tax Credit each year for 15 years. An investor in the Tax Credit is subject to recapture where noncompliance is found.

The new Tax Credit law requires states to provide "a procedure that the agency will follow in notifying the Internal Revenue Service of noncompliance with the provisions of this section which such agency becomes aware of." Congress appears likely to require states to take a more active role in compliance in the future. We are currently consulting with tax committee staff on a system they are considering under which allocating agencies would monitor projects for compliance.

States should, of course, be permitted to recover the added administrative costs for assuming this federal responsibility. In addition, since some states will have an inventory of as many as 500 Tax Credit projects with as many as 10,000 low income units by 1995, annual on-site audits of each project and review of records on each unit by the state itself may prove prohibitively expensive and no more effective than alternative methods using private resources, such as the accounting firms which monitor the financial condition of each project.

State HFAs must also be protected in such a monitoring role against potentially costly suits filed by dissatisfied owners. Remedies for noncompliance identified by states should be pursued by the IRS. Finally, systematic monitoring could benefit from resident involvement. We would look for ways to take advantage of this resource, especially where compliance with health and safety requirements is involved.

Florida is already implementing a system through which to monitor projects on a long-term basis. This system requires developers to submit both quarterly and annual compliance reports. The purpose of these reports is to ensure that the income levels of the low income households remain at or below the allowable limits, and that all low income units in the project are occupied by eligible tenants.

Florida has hired an independent contractor with underwriting and housing management experience, First Housing Corporation, to conduct the site visits and report their findings to the agency. On projects of 10 to 15 units, the contractor will be required to review all tenant files; on larger projects they will examine a sample of the total number of tenant files.

To be eligible for selection under the qualified allocation plan, Florida developers must agree to notify the agency within 45 days of allocation of their willingness to take a compliance course covering the audit process and tenant documentation, notify the agency of any change in management and ensure that management is knowledgeable about compliance.

Florida plans to charge annual monitoring fees of $550, $750 and $1,000, depending on project size. The annual fee will be discounted at seven percent over the 15-year period and assessed up front.

Florida also plans to begin monitoring projects which received the Tax Credit from 1987 through 1989. These projects will be subject to site visits and annual reports will be required for each project. The agency does not plan to retroactively assess a monitoring fee on pre-1990 projects.

With the Prohibition Against the Combination of the Tax Credit with Section 8 Mod Rehab, What Issues Remain that are Specific to Interplay Between the Tax Credit and Section 8?

The methodology which state agencies will use in evaluating projects, especially the impact of rental assistance subsidies, was developed by NCSHA after careful consideration. Since Section 8 Mod Rehab can no longer be used in combination with the Tax Credit under the 1989 Act, there is no need to discuss treatment of this subsidy.

Section 8 rental assistance affects a project by increasing the rental income on the low income units by an amount equal to the difference between the Fair Market Rent and the rents which can be charged under the Tax Credit (30 percent of the tenant's income adjusted for family size and utility allowance). The higher rental income causes a higher net operating income (NOI). A portion of this NOI is used to pay debt service and determine interest rates, terms, debt underwriting requirements, and the amount of debt which the project can sustain. Credits are allocated to fill the "equity gap" created by subtracting the amount of debt from the total project costs, including reasonable developers fees and less any direct grants.

The impact of Section 8 rental assistance depends on the degree to which it actually affects the amount of debt which a project can carry. The lender must determine whether the rental assistance will be available long enough to maintain a higher NOI and pay higher debt service over time. We do not expect lenders to base their debt underwriting on the possibility that transportable Section 8 certificates or vouchers will be available to a unit. Tenants may move and take the rental assistance with them after only one year and the next occupant may not be a certificate or voucher holder. It is too early to determine how lenders will assess the impact of project-based assistance (PBA) given that it has only a five-year contract term. If a lender is willing to underwrite a mortgage assuming the continuation of PBA, the gap needed to be closed by the Tax Credit will decrease.

Any portion of NOI related to rental assistance which does not go to pay debt service is considered project cash flow available for distribution to the owner. We are recommending to states that cash flow distribution be restricted on a percentage basis as a portion of equity based on performance. Any cash flow in excess of this allowed distribution would be placed in a residual receipts account controlled by the agency through the Extended Use Agreement. These residual receipts could be used to augment operating reserves or replacement reserves in an emergency if the agency deems appropriate. If the owner wishes to sell the property at year 15, funds in the residual receipts could be used to finance the acquisition by a buyer willing to commit to low income use through out the next 15 years.

Some FmHA assisted projects will have rental assistance. With FmHA projects, the rental assistance is attached to the low-interest, long-term loan FmHA provides. This loan is underwritten by FmHA according to underwriting procedures which consider the need for the rental assistance. Thus, we are recommending to the allocating agencies that FmHA allocations be based upon the amount of loan, accepting that FmHA has already underwritten in a way that makes maximum use of the rental assistance to pay debt service.

Conclusion

We have and will continue to fully pledge our resources and energy to the successful implementation of the new Tax Credit law. We are confident that the new Tax Credit program will operate efficiently and effectively. We ask for your help in ensuring the program's continued operation through enactment of a permanent program extension this year.

Thank you for the opportunity to be here this morning.

APPENDIX A
APRIL 27, 1990
TESTIMONY

Low-Income Housing Tax Credit Application

Application Type **(Check one)**

Date of Application ____________

☐ **Initial Application** ☐ **Reservation** ☐ **Binding Agreement/ Carryover Allocation** ☐ **Placed-in-Service**

Type of Low -Income Housing Tax Credit Requested

☐ **New Construction without Federal Subsidies**
☐ **New Construction with Federal Subsidies**
☐ **Acquisition/Rehabilitation without Federal Subsidies**
☐ **Acquisiton/Rehabilitation with Federal Subsidies**
☐ **Acquisition with 10-year waiver from Federal Agency**

Is this project in a Qualified Census Tract or High Cost Area ? ☐ **Yes** ☐ **No**

Project Name & Address **(Complete the information listed below)**

Name ____________ **Census Tract** ____________
Address ____________ **County** ____________
City ____________ **State** ________ **Zip Code** ________

Project Located in an Metropolitan Statistical Area ☐

Congressional District ________ **State Senate District** ________ **State House District** ________

Developer Information ☐ **For-Profit** ☐ **Nonprofit** *(Nonprofits must complete nonprofit developer information on page 2)*

Name (s) ____________ **Address** ____________
City ____________ **State** ____________ **Zip Code** ____________
Telephone ____________ **Fax** ____________

Partnership Information *(Please note: The HFA reserves tax credits to the partnership and general partners. Reservations are not transferrable. Any changes in general partner status requires a new application.)*

☐ For-Profit ☐ Nonprofit *(Complete information below)*

Name of Partnership ____________________ Federal ID Number __________

Name of General Partner(s)

____________________ Telephone ____________ % Ownership ______%

____________________ Telephone ____________ % Ownership ______%

____________________ Telephone ____________ % Ownership ______%

Are you requesting low-income housing tax credit from the nonprofit set-aside? ☐ Yes ☐ No

---

Previous Participation of General Partner or Developer

List all projects in which the developer(s) or general partner(s) have requested an allocation of low-income housing tax credits or sold a project which received an allocation of low-income housing tax credits. Attach a separate sheet with additional information if necessary.

Project Name and Location	Date of Application	Status of Project

---

Nonprofit Determination If this project is to be considered for the nonprofit set-aside, the following information must be completed.

Articles of Incorporation and IRS documentation of status must be attached with Application.

To qualify for the nonprofit set-aside, the applicant must materially participate in the development and operation of the project throughout the compliance period. Within the meaning of IRC 469(h), "a (nonprofit) shall be treated as materially participating in an activity only if the (nonprofit) is involved in the operations of the activity on a basis which is regular, continuous, and substantial."

☐ 501 (c) (3) Organization ☐ 501 (c) (4) Organization ☐ Exempt purposes includes fostering of Low-Income Housing

☐ Exempt from tax under Section 501 (a) ☐ Other: ____________

Describe the nonprofit's participation in the development and operation of the project.

____

____

____

____

____

____

List the names of Board Members for the nonprofit organization.

Identify all paid full-time staff and sources of funds for annual operating expenses and current programs.

Development Team Information

Each member of the development team must submit a resume which lists qualifications, address and telephone number.

Name of Developer ____________________

Name of General Partner ____________________

Name of Contractor ____________________

Name of Management Company ____________________

Name of Sponsoring Organization ____________________

Name of Consultant ____________________

Name of Tax Attorney ____________________

Name of Tax Accountant ____________________

Please list any direct or indirect, financial or other interest a member of the development team may have with another member of the development team. List "none" if there are no identities of interest.

Syndication Information

Provide information below concerning syndication and estimated proceeds from sale of tax credits.

Low-Income Housing Tax Credits ____________ Historic Rehabilitation Tax Credits ____________

When are these funds paid? ____________________

Type of Offering ☐ Public ☐ Private

Type of Investors ☐ Individuals ☐ Corporations

Name of Fund ____________________

Name of Syndicator ____________________ Telephone ( ) ____________

Address ____________________ State ____________ Zip ____________

Project Information ☐ New Construction ☐ Rehabilitation ☐ Acquisition and Rehabilitation

Total Number of Units: _____ Number of Low -income Units _____

Percent of Units Low-income _____% Percent of Floor Area Low-income _____ %

☐ Row House / Townhouse ☐ Detached Single Family ☐ Detached Two-family

☐ Garden Apartments ☐ Elevator: Number of Stories _______

☐ Slab on Grade ☐ Crawl Space ☐ Partial Basement ☐ Full Basement

Type of Unit

☐ Multifamily Rental Residential ☐ Single Room Occupancy Housing

☐ Transient Housing ☐ Other____________________

Targeting of Units

☐ Elderly, number of units ________ ☐ Family, number of units ________

☐ Handicapped, number of units ________ ☐ Other , number of units ________

Accessory Buildings & Area____

List Recreation Facilities ____

Commerical Facilities ____

Number of Buildings _____ Total Number of Parking Spaces _____

Gross Floor Area of all Buildings: ________ (Square Feet) Non-residential Floor Area ________ (Square Feet) Residential Floor Area ________ (Square Feet)

Site Information Provide information concerning the proposed site(s)

Is site currently under control for the project? ☐ Yes ☐ No

If yes, control is in the form of: ☐ Deed ☐ Option ☐ Purchase Contract ☐ Other:

Expiration date of contract or option ____________ month/year ________________

Total Cost of Land __________ Exact Area of Site ______________ Acres or Square Feet Circle one

Name of Seller ______________________________________

Address ______________________________________ City ____________________

State ____________ Phone Number (   ) ______________

Is site properly zoned for your development? ☐ Yes ☐ No

If no, is site currently in the process of rezoning? ☐ Yes ☐ No

When is the zoning issue to be resolved? ________________ month/year

Are all utilities presently available to the site? ☐ Yes ☐ No

If no, which utilities need to be brought to the site? ______________________________

The following information must be included with the application: Site Control document, documentation of proper zoning and sketch plan of site. Attach separate sheet(s) with additional information as needed.

Acquisition of Exisiting Buildings

How many buildings will be acquired for the project? ____________

Are all the buildings currently under control for the project? ☐ Yes ☐ No

If no, how many building are under control for the project? ____________

When will the rest of the building be under control for acquisition? ____________

List Buildings Under Control Address(es) of building		Type of Control: Ownership, Option, Purchase Contract	Expiration Date of Control Document	Number of Units	Acquisition Cost of Building
1.					
2.					
3.					
4.					
5.					
6.					
7.					

Acquisition Information Provide the information listed below concerning the acquisition of building(s) for the project.

Building(s) acquired or to be acquired from ☐ Related Party ☐ Unrelated Party

Building(s) acquired or to be acquired with Buyer's Basis ☐ Determined with reference to Seller's Basis

☐ Not Determined with reference to Seller's Basis

List below by Building Address, the date the building was placed in service , date the building was or is planned for acquisition, and the number of years between the date the building was placed in service and date of acquisition. Attach separate sheet(s) with additional information as necessary.

Address(es) of building		Placed-in-Service Date of Building by the most recent owner	Proposed Date of Acquisition by Applicant	Number of years between PIS & Acquisition
1.				
2.				
3.				
4.				
5.				
6.				
7.				

Relocation Information Provide information concerning any relocation on the project.

Does this project involve any relocation of tenants? ☐ Yes ☐ No

If yes, please describe the proposed relocation assistance.

Project Costs List and Indicate Eligible Basis by Credit Type. (Residential Portion Only)

Itemized Cost	Actual Cost	Adjustment for High Cost Areas	Eligible Basis by Credit Type 30% PV Eligible Basis	70% PV Eligible Basis
To Purchase Land and Buildings				
Land				
Existing Structures				
Demolition				
Other				
For Site Work				
Site Work				
Off Site Improvement				
Other				
For Rehabilitation and New Construction				
New Building				
Rehabilitation				
Accessory Building				
General Requirements				
Contractor Overhead				
Contractor Profit				
Other				
For Contingency				
Construction Contingency				
Other				
For Architectural and Engineering Fees				
Architect Fee - Design				
Architect Fee - Supervision				
Real Estate Attorney				
Consultant or Processing Agent				
Other Fees				
Other Fees				
Other Fees				
Other Fees				
For Interim Costs				
Construction Insurance				
Construction Interest				
Constr Loan Origin Fee				
Constr Loan Credit Enhancement				
Taxes				
For Financing Fees and Expenses				
Bond Premium				
Credit Report				
Permanent Loan Origin Fee				
Perm Loan Credit Enhancement				
Cost of Iss/Underwriters Discount				
Title and Recording				
Counsel's Fee				
Other				
Other				
Subtotal				

List Total Project Costs and Identify Eligible Basis by Credit Type. (Continued)

Itemized Cost	Actual Cost	Adjustment for High Cost Areas	Eligible Basis by Credit Type 30% PV Eligible Basis	70% PV Eligible Basis
For Soft Costs				
Property Appraisal (Feasibility)				
Market Study				
Environmental Report				
Tax Credit Fees				
Rent-up				
Consultants				
Other				
For Syndication Costs				
Organizational (Partnership)				
Bridge Loan Fees and Expenses				
Tax Opinion				
Other				
For Developer's Fees				
Developer's Overhead				
Developer's Fee				
Other				
For Project Reserves				
Rent-up Reserve				
Operating Reserve				
Other				
Other				
Other				
Subtotal				
Subtotal from previous page				
Total				
Less portion of federal grant used to finance qualifying development costs. List Grants			( )	( )
Less amount of nonqualified nonrecourse financing			( )	( )
Less nonqualifying units of higher qualify			( )	( )
Less nonqualifying excess portion of higher quality units			( )	( )
Less Historic Tax Credit (Residential Portion Only)			( )	( )
Total Eligible Basis				
Multiplied by the Applicable Fraction			%	%
Total Qualifed Basis				
Multiplied by the Applicable Percentage			%	%
TOTAL AMOUNT OF TAX CREDIT REQUESTED:				

(PLEASE NOTE: The actual amount of credit for the project is determined by the housing credit agency. If the project is eligible for Historic Tax Credit include a complete breakdown of the determination of eligible basis for the Historic Credit with the application. If the Project's basis has been adjusted because it is in a high cost or qualified census tract, the actual deduction for the Historic Cost items must be adjusted by multiplying the amount by 130%. This does not apply to Historic Tax Credits.)

Project Income Information

Do or will any low-income units receive or will receive Rental Assistance? ☐ Yes ☐ No

If yes, list the type of Rental Assistance:

- ☐ Section 8 New Construction Substantial Rehabilitation
- ☐ Section 8 Moderate Rehabilitation
- ☐ Section 8 Certificates
- ☐ Section 8 Project Based Assistance
- ☐ FmHA 515 Rental Assistance
- ☐ Section 8 Vouchers
- ☐ State Assistance
- ☐ __________

Number of units receiving Assistance ______ Number of years Rental Assistance contract ________

Project Rents

List the Applicable Low-Income Tax Credit Rents and the Actual Proposed Gross Rents for the Project.

	0-Bdr	1-Bdr	2-Bdr	3-Bdr	___ Bdr
Actual Gross Rents for Project					
50% of Area Median Income					
60% of Area Median Income					

Low-Income Units Only

List the estimated monthly income for the low-income units.

Total number of Low-Income Units ________

	Number of Units	Monthly Rent per Unit	Total Monthly Rent by Unit Type	Average SF of Unit
___Bedroom				
___Bedroom				
___Bedroom				
___Bedroom				
___Bedroom				

Other Income Source: ________________ ______________

Less Vacancy Allowance ____% (______________)

Total Monthly Income ______________

What is the estimated annual percentage increase in annual income? ________ %

Market Rate Units Only

List the estimated monthly income for the market rate units.

Total number of Market Rate Units ________

	Number of Units	Monthly Rent per Unit	Total Monthly Rent by Unit Type	Avg Sq Ft of Unit
___Bedroom				
___Bedroom				
___Bedroom				
___Bedroom				

Other Income Source: ____________________ ______________

Less Vacancy Allowance ____% (______________)

Total Monthly Income ______________

Energy and Equipment Information

Energy Equipment	Type System (Forced Air, Hot Water, Etc.)	Efficiency Rating
Heating		
Air Conditioner		
Domestic Hot Water		

Equipment Included with Unit (Low-Income Units)

☐ Range ☐ Refrigerator ☐ Disposal ☐ Dishwasher
☐ Air Conditioner ☐ Kitchen Exhaust Fan ☐ Other ____________________
☐ Laundry Facilities (on site) ☐ Washer & Dryer Hook-up

Equipment Included with Unit (Market Rate Units)

☐ Range ☐ Refrigerator ☐ Disposal ☐ Dishwasher
☐ Air Conditioner ☐ Kitchen Exhaust Fan ☐ Other ____________________
☐ Laundry Facilities (on site) ☐ Washer & Dryer Hook-up

Monthly Utility Allowance Calculations

Utilities	Type of Utility (Gas, Electric, Oil, etc)	Utilities paid by:	Enter Allowances by Bedroom Size				
			0-Bdr	1-Bdr	2-Bdr	3-Bdr	___ Bdr
Heating		☐ Owner ☐ Tenant					
Air Conditioning		☐ Owner ☐ Tenant					
Cooking		☐ Owner ☐ Tenant					
Lighting		☐ Owner ☐ Tenant					
Hot Water		☐ Owner ☐ Tenant					
Water		☐ Owner ☐ Tenant					
Sewer		☐ Owner ☐ Tenant					
Trash		☐ Owner ☐ Tenant					
		Total Utility Allowance for units					

Source of Utility Allowance Calculation

☐ State PHA ☐ Local PHA ____________________
☐ Utility Company ☐ Other ____________________

Documentation of utility calculations must be included with application

---

Minimum Set-Aside Election

The Owner irrevocably elects one of the Minimum Set-Aside Requirements (Check one Only)

☐ **At least 20% of the rental residential units in this development are rent-restricted and to be occupied by individuals whose income is 50% or less of area median income**

☐ **At least 40% of the rental residential units in this development are rent-restricted and to be occupied by individuals whose income is 60% or less of area median income**

☐ **Deep rent skewing option as defined in Section 42**

Annual Expense Information

Administrative

1. Advertising ______
2. Management ______
3. Legal/Partnership ______
4. Accounting /Audit ______
5. Other ______

Total Administrative Cost ______

Maintenance

1. Decorating ______
2. Repairs ______
3. Exterminating ______
4. Ground Expense ______
5. Other______ ______

Total Maintenance Cost ______

Operating

1. Elevator ______
2. Fuel (Heating & Hot Water) ______
3. Lighting & Misc. Power ______
4. Water/Sewer ______
5. Gas ______
6. Trash Removal ______
7. Payroll/Payroll Taxes ______
8. Insurance ______

Total Operating Cost ______

Real Estate Taxes ______

Real Estate Taxes ______

Total Taxes ______

Total Annual Operating Expenses ______

Annual Replacement Reserve for Units ______

What is the estimated annual percentage increase in annual expenses? ______ %

Source of Funds (Construction and Permanent Financing

Construction Financing

List individually the source of construction financing.

	Source of Funds	Amount of Funds	Name and Telephone Number of Contact Person
1.			
2.			
3.			
	Total Source of Funds for Construction		

Permanent Financing

List Permanent Financing for the Project at Closing.
(Do not include construction financing.)

	Name of Lender or Source of Funds	Amount of Funds	Annual Debt Service Cost	Interest Rate of Loan	Amortiza-tion Period	Term of Loan
1.						
2.						
3.						
4.						
5.	Proceeds from Low-Income Tax Credits					
6.	Proceeds from Historic Tax Credits					

Total Source of Funds ____________ Total Annual Debt Service Cost ____________

All Financial Commitments

List all Source of Funds provided for the project.
Commitment letters must be included with application

Name of Lender or Source of Funds	Date of Commitment	Name & Telephone number of Contact Person
1.		
2.		
3.		
4.		
5.		
6.		

Source of Funds (Grants and Other Moneys)

Is any portion of the Source of Funds for the project financed directly or indirectly with Federal, State, or Local Government Funds? ☐ Yes ☐ No

If yes, then check the type and list the amount of the moneys involved.

☐ Tax-Exempt Financing $______________

☐ CDBG Financing	$______________	☐ CDBG Grant	$______________
☐ UDAG Financing	$______________	☐ UDAG Grant	$______________
☐ HoDAG Financing	$______________	☐ HoDAG Grant	$______________
☐ FmHA 515 Financing	$______________	☐ State Grant	$______________
☐ Rental Rehabilitation Grant Financing	$______________	☐ Local Grant	$______________
☐ Other	$______________	☐ Other	$______________

If Tax-Exempt financing is used, list the percentage of the tax-exempt financing to the total cost of project ______ %

Is Taxable Bond Financing used? ☐ Amount $ ______________

Credit Enhancements

Will the permanent financing have any type of credit enhancement? ☐ Yes ☐ No

If yes, list type of enhancement ______________________________

Existing Subsidies with Acquisition Projects

☐ Section 221(d)(3) BMIR

☐ Section 236

☐ Section 8 Rent Supplement or Rental Assistance payment

Is HUD Approval for Transfer of Physical Asset Required? ☐ Yes ☐ No

---

Notification of Local Official

Provide the name of the local political jurisdiction in which the project shall be located, and include the name and address of the chief executive officer of the political jurisdiction.

Name of Political Jurisdiction ______________________________

Name of Chief Executive Officer ______________________________

Title ____________________

Address ____________________ City ____________________

Zip Code __________ Telephone ( ) ______________

Project Schedule

Activity	Scheduled Date Month/Year
A. Site	▨
Option/Contract	
Site Acquisition	
Zoning Approval	
Site Analysis	
B. Financing	▨
1. Construction Loan	
Loan Applicaton	
Conditional Commitment	
Firm Commitment	
2. Permanent Loan	▨
Loan Applicaton	
Conditional Commitment	
Firm Commitment	
3. Other Loans & Grants	▨
Type & Source	
Application	
Award	
4. Other Loans & Grants	▨
Type & Source	
Application	
Award	
5. Other Loans & Grants	▨
Type & Source	
Application	
Award	
C. Plans and Specifications, Working Drawings	
D. Closing and Transfer of Property	
E. Construction Begins	
F. Completion of Construction	
G. Lease-up	
H. Credit Placed in Service Date	

Determining Qualified Basis on a building by building basis

Qualified basis must be determined on a building-by-building basis. Complete the section below. Building Addresses are required.

Address (must be complete)	Eligible Basis 30% PV	Applicable Fraction	Qualified Basis	Eligible Basis 70% PV	Applicable Fraction	Qualified Basis	High Cost Credit Area	Placed-In-Service Date
1.							☐ Yes ☐ No	
2.							☐ Yes ☐ No	
3.							☐ Yes ☐ No	
4.							☐ Yes ☐ No	
5.							☐ Yes ☐ No	
6.							☐ Yes ☐ No	
7.							☐ Yes ☐ No	
8.							☐ Yes ☐ No	
9.							☐ Yes ☐ No	
10.							☐ Yes ☐ No	
11.							☐ Yes ☐ No	
12.							☐ Yes ☐ No	
13.							☐ Yes ☐ No	
Totals								

Determining Qualified Basis on a building by building basis

Complete this section if the project contains more than thirteen buildings. Make extra copies if necessary.

Address (must be complete)	Eligible Basis 30% PV	Applicable Fraction	Qualified Basis	Eligible Basis 70% PV	Applicable Fraction	Qualified Basis	High Cost Credit Area	Placed-in-Service Date
							☐ Yes ☐ No	
							☐ Yes ☐ No	
							☐ Yes ☐ No	
							☐ Yes ☐ No	
							☐ Yes ☐ No	
							☐ Yes ☐ No	
							☐ Yes ☐ No	
							☐ Yes ☐ No	
							☐ Yes ☐ No	
							☐ Yes ☐ No	
							☐ Yes ☐ No	
							☐ Yes ☐ No	
							☐ Yes ☐ No	
Totals							▨	▨

Application Fee

Total Amount of Annual Tax Credit Requested ________________

☐ **Projects with eight units or less $150.00**

☐ **Projects with more than eight units $500.00**

The Application fee must be included with the Application. Make all checks payable to:

Reservation Fee

A Reservation fee equal to 3% of the total annual tax credit amount approved by the agency will be required at time of Reservation.

HFA inserts section which request information needed to conform to Allocation Plan.

The undersigned is responsible for ensuring that the project consists or will consist of a qualified low-income building or buildings as defined in the Internal Revenue Code, Section 42, and will satisfy all applicable requirements of federal tax law in the acquisition, rehabilitation, or construction and operation of the project to receive the low-income housing credit.

The undersigned is responsible for all calculations and figures relating to the determination of the eligible basis for the building and understands and agrees that the amount of the credit is calculated by reference to the figure submitted with this application, as to the eligible basis and qualified basis of the project and individual buildings.

The Undersigned hereby makes Application to the State of _______________, carryover allocation, or allocation of housing credit dollar amounts as listed in the application. The undersigned agrees that the _____________ Housing Finance Agency will at all times be indemnified and held harmless against all losses, costs, damages, expenses and liabilities whatsoever nature or kind (including, but not limited to attorney's fees, ligation and court costs, amounts paid in settlement, and amounts paid to discharge judgment, any loss from judgment from Internal Revenue Service) directly or indirectly resulting from, arising out of, or related to acceptance, consideration and approval or disapproval of such allocation request.

The Undersigned, being duly authorized, hereby represents and certifies that the foregoing information, to the best of his/her knowledge, is true, complete and accurately describes the proposed project.

IN WITNESS WHEREOF, the owner has caused this document to be duly executed in its name on this ______ day of ___________________, 19______.

____
Legal Name of Owner

By: ______________________________________
Name

____
Title

STATEMENT

OF

DAVID BLATTNER
ASSISTANT COMMISSIONER (EXAMINATION)
INTERNAL REVENUE SERVICE

BEFORE

THE

UNITED STATES SENATE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
HUD/MOD REHAB INVESTIGATION SUBCOMMITTEE

CONCERNING

THE LOW-INCOME HOUSING CREDIT

ON

APRIL 27, 1990

INTRODUCTION

THANK YOU FOR THE OPPORTUNITY TO TESTIFY REGARDING THE ADMINISTRATION OF THE LOW-INCOME HOUSING TAX CREDIT. AS THE ASSISTANT COMMISSIONER (EXAMINATION) I AM RESPONSIBLE FOR THE ADMINISTRATION OF IRS' EXAMINATION PROGRAMS NATIONWIDE. HERE WITH ME TODAY IS SUSAN REAMAN OF THE OFFICE OF CHIEF COUNSEL.

BEFORE I DISCUSS HOW IRS ADMINISTERS THIS CREDIT, I WOULD LIKE TO PROVIDE SOME BACKGROUND ON HOW THE IRS PROCESSES AND EXAMINES TAX RETURNS. I WILL ALSO BRIEFLY DESCRIBE AN IRS PROJECT ON TAX EXEMPT LOW-INCOME HOUSING INDUSTRIAL DEVELOPMENT BONDS.

OVERVIEW

THE TEN IRS SERVICE CENTERS ARE THE DATA PROCESSING ARM OF IRS. AS TAX RETURNS ARE RECEIVED AT THE SERVICE CENTERS, EMPLOYEES VERIFY THAT ALL REQUIRED FORMS ARE ATTACHED AND THAT ALL COMPUTATIONS ARE MATHEMATICALLY CORRECT. DATA IS THEN TRANSCRIBED FROM THE RETURNS FOR INPUT TO A MASTER FILE WHICH CONTAINS RECORDS OF ALL INDIVIDUAL AND BUSINESS TAX ACCOUNTS.

EXAMINATION ADMINISTERS A NATIONWIDE PROGRAM INVOLVING THE SELECTION AND EXAMINATION OF ALL TYPES OF FEDERAL TAX RETURNS

TO DETERMINE THE CORRECT TAX LIABILITIES OF TAXPAYERS. SEVERAL SELECTION METHODS ARE USED TO SELECT RETURNS FOR EXAMINATION. OUR TAXPAYER COMPLIANCE MEASUREMENT PROGRAM (TCMP) PERIODICALLY GATHERS DATA ON COMPLIANCE THROUGH DETAILED EXAMINATIONS OF RANDOMLY SELECTED TAX RETURNS. THE TCMP RESULTS ARE THEN USED IN DEVELOPING OUR DISCRIMINANT FUNCTION (DIF) SELECTION SYSTEM WHICH IS A COMPUTER PROGRAM USING MATHEMATICAL TECHNIQUES TO SELECT THE MOST PRODUCTIVE RETURNS FOR EXAMINATION. AN EXAMINATION MAY ALSO BE INITIATED AS A RESULT OF OUR MATCHING PROGRAMS WITH INFORMATION RETURNS SUCH AS FORMS W-2 PROVIDED BY EMPLOYERS OR FORMS 1099 PROVIDED BY BANKS OR OTHER PAYERS OF INCOME. OUR TAX SHELTER PROGRAM, ABUSIVE PROTESTER PROGRAM, FRAUD PROGRAM AND DISTRICT DIRECTED LOCAL SOURCE PROGRAMS ALSO LEAD TO A SIGNIFICANT NUMBER OF EXAMINATIONS. ADDITIONALLY, OUR COORDINATED EXAMINATION PROGRAM (CEP) REVIEWS AND EXAMINES THE RETURNS OF THE LARGEST CORPORATIONS.

ONCE A RETURN HAS BEEN SELECTED FOR EXAMINATION, IT IS SENT TO ONE OF OUR 63 DISTRICT OFFICES LOCATED ACROSS THE COUNTRY AND FORWARDED TO A REVENUE AGENT OR TAX AUDITOR TO CONDUCT THE EXAMINATION. THE FIRST RETURNS WHICH COULD REFLECT THE LOW-INCOME HOUSING TAX CREDIT ARE THOSE FOR TAX YEARS 1987 AND 1988. THESE TAX YEARS ARE CURRENTLY IN THE

EXAMINATION PROCESS. PRELIMINARY INDICATIONS ARE THAT THE MAJORITY OF TAXPAYERS DEVELOPING LOW-INCOME HOUSING PROJECTS ARE PARTNERSHIP ENTITIES.

THE LOW-INCOME HOUSING CREDIT

THE LOW-INCOME HOUSING CREDIT (LIHC) CONTAINED IN INTERNAL REVENUE CODE SECTION 42 WAS ENACTED AS PART OF THE TAX REFORM ACT OF 1986. THE CREDIT IS TAKEN OVER A 10 YEAR PERIOD. THE CREDIT AMOUNT IS APPROXIMATELY EITHER NINE OR FOUR PERCENT PER YEAR DEPENDING ON THE METHOD OF FINANCING. THE 1986 ACT ESTABLISHED A REQUIREMENT THAT THE RENTAL UNITS BE MAINTAINED AS LOW-INCOME HOUSING FOR 15 YEARS. THE CREDIT WAS TO TERMINATE AFTER 1989. SUBSEQUENTLY, THE OMNIBUS BUDGET RECONCILIATION ACT OF 1989 EXTENDED THE CREDIT THROUGH DECEMBER 31 OF THIS YEAR AND PROVIDES FOR AN ADDITIONAL 15 YEAR COMMITMENT.

THERE ARE VARIOUS ADDITIONAL RULES RELATING TO INCOME LEVELS OF THE TENANTS, RENT RESTRICTIONS, FAMILY SIZE, STRUCTURAL HABILTABILITY AND SO FORTH. FAILURE TO COMPLY WITH CERTAIN TESTS FOR THE COMPLIANCE PERIOD MAY RESULT IN A REQUIREMENT THAT THE CREDIT BE RECAPTURED. RECAPTURE IS ALSO REQUIRED IF THERE IS A DISPOSITION OF THE PROPERTY UNLESS A BOND IS POSTED.

THE BUILDING OWNER MUST APPLY TO THE APPROPRIATE STATE OR LOCAL HOUSING CREDIT AGENCY FOR ALLOCATION OF AUTHORIZED CREDIT FOR EACH BUILDING. EACH AGENCY IS AUTHORIZED TO ALLOCATE A CERTAIN AMOUNT OF LOW-INCOME HOUSING CREDITS EACH YEAR BASED ON POPULATION. THE STATE OR LOCAL AGENCY WILL REVIEW THE APPLICATION AND IF GUIDELINES ARE MET, WILL ISSUE A LOW-INCOME HOUSING CREDIT ALLOCATION CERTIFICATION, FORM 8609, TO THE BUILDING OWNER AND WILL ASSIGN A BUILDING IDENTIFICATION NUMBER (BIN). AT YEAR'S END, THE STATE AND LOCAL AGENCIES FILE COPIES OF THE ISSUED ALLOCATION CERTIFICATIONS WITH OUR PHILADELPHIA SERVICE CENTER.

BUILDING OWNERS CLAIMING THE CREDIT MUST ATTACH A COPY OF THE ORIGINAL ALLOCATION CERTIFICATION TO THEIR FEDERAL INCOME TAX RETURN FOR EACH BUILDING FOR EACH YEAR OF THE 15 YEAR COMPLIANCE PERIOD. THEY MUST ALSO RECERTIFY EACH YEAR THAT THE BUILDING CONTINUES TO QUALIFY AS PART OF A LOW-INCOME HOUSING PROJECT. IN ADDITION, THEY MUST PROVIDE INFORMATION REGARDING DISPOSITIONS AND DECREASES IN QUALIFYING BASIS.

IRS' ADMINISTRATION OF THE LOW-INCOME HOUSING CREDIT

WE HAVE IMPLEMENTED PROCEDURES TO INSURE TAXPAYERS ARE PROVIDING THE REQUIRED DOCUMENTATION TO CLAIM THE CREDIT.

When a tax return claiming the low-income housing credit is filed, our service centers check to see if a properly completed and signed allocation certification is attached. If it is not, we correspond with the taxpayer since the credit will not be allowed without the certification.

We have also established a tracking system for the credit to ensure that buildings are maintained in service for the 15 year compliance period. A database has been established which tracks the BIN and the amount of qualified basis. This information is taken from the allocation certification attached to tax returns. Whenever there is a decrease in qualified basis or cessation of credit being taken for a particular BIN, potential recapture of the accelerated portion of the credit exists. If the taxpayer has not properly recaptured the credit or posted a bond, appropriate correspondence will be sent to the taxpayer (building owner).

An additional tracking system is under development to match the information on the building owner's tax return with the information filed by the state and local housing authorities. This system will also be utilized to compare the total amount of credit allocated by any agency with their authorized amount.

Special compliance teams at the service centers are responsible for identifying emerging trends, problems and areas of abuse. These teams have been alerted to watch for any issues regarding the low-income housing credit.

As I mentioned in my introduction, I would like to discuss a project that the IRS recently conducted on tax exempt industrial development bonds issued on low-income housing projects. This involved the examination of 80 information returns for tax exempt private activity bond issues. These returns are required to be filed by the bond issuers to meet the requirements for tax exemption. The project is intended to measure compliance with the requirements to maintain 20% of the project as low-income housing, to ensure the low-income tenants were certified using income certification, and to ensure 90% of the proceeds were expended on the project within 3 years. Preliminary results of the examinations indicate a very high compliance rate with the requirements. The final report on the project has not been completed but we will provide the committee with a copy of the report when it is completed.

IRS Experience to Date

There has been a relatively limited number of taxpayers claiming the LIHC on their tax returns even though the state and local agencies have issued allocations approaching their statutory limits. This is due to the nature of the type of projects involved and the requirements of the credit provisions. The credit can only be claimed on a tax return starting in the year the building is placed in service, or the succeeding tax year. Since the credit was established by the 1986 Act, the first returns filed which could have claimed the credit are returns for tax year 1987. Many of the projects require considerable time in planning and construction prior to being placed in service. Consequently, many taxpayers have not yet been eligible to claim the credit on a tax return even though they have received a credit allocation. We expect that an increased number of returns will claim the credit for tax year 1989. Because of this, IRS has little empirical data specifically addressing LIHC compliance by taxpayers. Thus, IRS is not in a position to assess the current compliance rate. This will change over the next few years as the credit is claimed on more returns and those returns are examined thereby providing data on compliance.

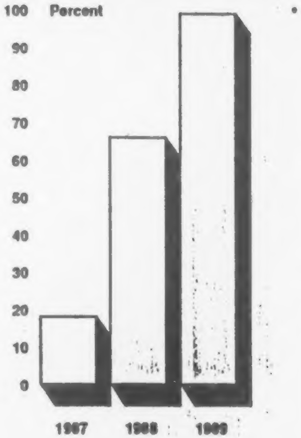
CONCLUSION

IN SUMMARY, AS PART OF OUR OVERALL TAX ADMINISTRATION AND COMPLIANCE EFFORTS, WE ARE PURSUING VARIOUS APPROACHES TO ENSURE THAT TAXPAYERS ARE COMPLYING WITH THE LIHC REQUIREMENTS. TAX RETURNS CLAIMING THE CREDIT ARE SCREENED TO VERIFY THAT THE LIHC ALLOCATION CERTIFICATE IS PROPERLY ATTACHED AND EXECUTED. WE ARE TRACKING THE AMOUNT OF QUALIFIED BASIS IN THE BUILDINGS TO IDENTIFY WHEN BUILDINGS ARE SOLD OR OTHERWISE DISPOSED OF AND WHEN TAXPAYERS WOULD BE SUBJECT TO RECAPTURE OF THE CREDIT. WE ARE ALSO BUILDING A SYSTEM TO MATCH INFORMATION RECEIVED FROM THE STATE AND LOCAL HOUSING AGENCIES WITH THE AMOUNTS REPORTED ON TAX RETURNS CLAIMING THE CREDIT. ADDITIONALLY, OUR SERVICE CENTER COMPLIANCE TEAMS HAVE BEEN ALERTED TO WATCH FOR POTENTIAL ABUSES INVOLVING THE LIHC.

THANK YOU FOR THE OPPORTUNITY TO APPEAR HERE TODAY. WE WILL BE HAPPY TO ANSWER ANY QUESTIONS YOU MAY HAVE.

Filename: b:CHART-1
01-20-1990 13:45:45

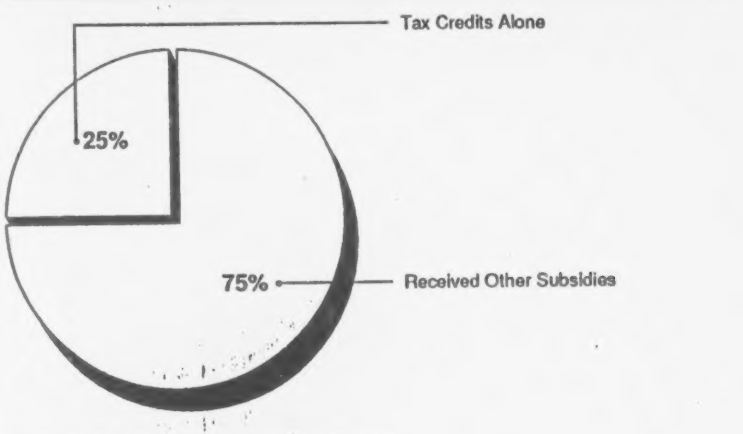
TAX CREDITS ALLOCATED



Source: National Council for State Housing Agencies.

Filename: b:CHART-2
04-20-1990 13:46:46

TAX CREDIT'S USE WITH OTHER SUBSIDIES

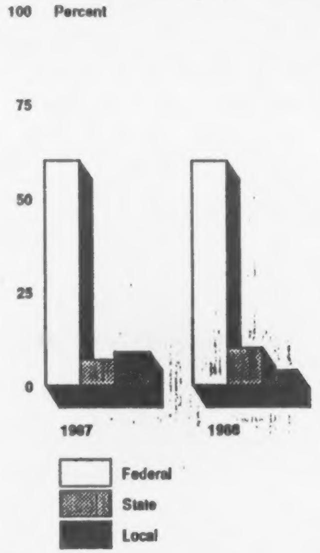


Source: National Council for State Housing Agencies

Data is for 1987-88. Data for 1989 was unavailable.

Filename: b:CHART-3
04-20-1990 13:44:13

SOURCE OF OTHER SUBSIDIES USED WITH TAX CREDIT

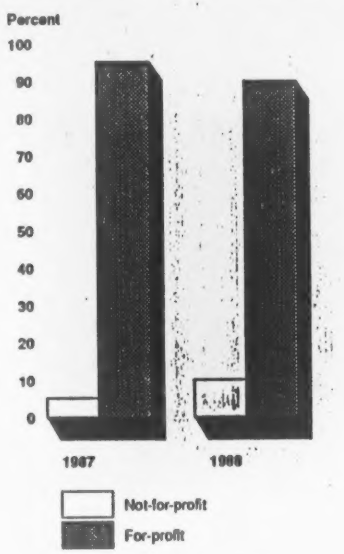


Source: National Council for State Housing Agencies.

Data for 1989 was unavailable.

Filename: b:CHART-4
04-20-1990 13:44:22

THE TAX CREDIT USER

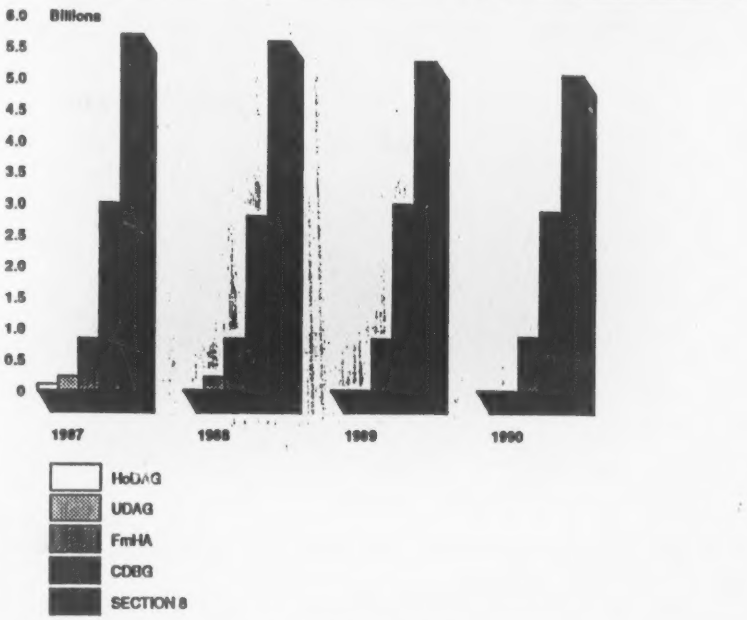


Source: National Council for State Housing Agencies.

CHART 5

Filename: a:SUBSIDY
04-24-1990 10:01:26

APPROPRIATIONS FOR MAJOR SUBSIDY PROGRAMS WHICH CAN BE USED WITH THE TAX CREDIT

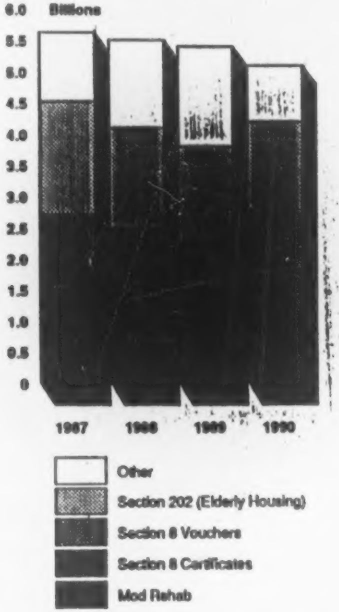


No new appropriations were provided to HoDAG from 1988-90 or to UDAG from 1989-90.

Amounts listed for FmHA are actually for loan authority, not appropriations.

CHART 6
Filename: a:SECTION.8
04-24-1990 10:03:22

APPROPRIATIONS FOR MAJOR COMPONENTS OF THE SECTION 8 PROGRAM



Mod Rehab did not receive any appropriations after 1989 except for homeless assistance and contract amendments.

The Other category includes appropriations for property disposition, loan management, and amendments to existing contracts.

CONGRESSIONAL OVERSIGHT OF HUD

TUESDAY, MAY 8, 1990

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
HUD/MOD REHAB INVESTIGATION SUBCOMMITTEE,
Washington, DC.

The subcommittee met at 10:15 a.m., in room SD–538 of the Dirksen Senate Office Building, Senator Bob Graham (chairman of the subcommittee) presiding

OPENING STATEMENT OF SENATOR GRAHAM

Senator GRAHAM. I call the meeting to order.

Good morning.

It has been nearly 1 year since the Senate Banking Committee began its investigations into allegations of mismanagement, fraud and abuse in the Department of Housing and Urban Development.

The series of hearings held by our full committee and continued by this subcommittee, continue the actions of the HUD Inspector General's report, issued on April 17, 1989, that detailed abuses in the section 8 Mod Rehab Program.

At our first hearing, I stated that the IG report opened the eyes of the Congress and the nation to the flagrant abuses that were occurring within the Department of Housing and Urban Development.

Today, as the subcommittee nears the end of its schedule of hearings, it is appropriate that we examine the process by which the Inspector General reports problems to the Congress.

We also want to examine how Congress can keep its eyes open so that they are not jarred awake by a report of long-standing abuses. In other words, we need to examine the role of Congress in overseeing HUD.

When Congress enacted the Inspector General Act in 1978, the Office of Inspector General was created at HUD and eleven other agencies. The first HUD IG was Mr. Charles Dempsey, who served in that position until 1985. He was followed by the current Inspector General, Mr. Paul Adams.

We are pleased to have both of these gentlemen appear before the subcommittee today to evaluate with us the warnings they gave on the scandals that have been uncovered and investigated. We intend to explore with them how that system and their relationship to this committee and Congress can be improved.

Joining them in the first panel will be Mr. Frederick Kaiser of the Congressional Research Service. He is familiar with the responsibilities of the Inspectors General and their relationship to their agencies and Congress.

We will later discuss with our second panel, broader issues relating to Congressional oversight.

It is not our intention to lay blame for the problems at HUD upon the Congress, but we do believe that Congress has an important role to play in being mindful of whether the will of Congress is being properly executed by the agencies of the executive branch. One approach is for Congress to be a fireman, dealing with crises that have been exposed. Another is for Congress to be a mechanic that gets involved in the detailed fixing of problems.

I believe the appropriate role for Congress is that of a pilot who gives policy direction to the agency and thus plays a proactive rather than a reactive role to the implementation of that program. Congress cannot manage programs but it must know if they are being mismanaged.

A number of oversight tools are available to Congress. We will examine some of those today.

The semiannual reports of the Inspector General are an important tool of the Congress whereby it can learn of problems at an agency. Another is the Federal Managers Financial Integrity Act report which was the subject of an earlier hearing. GAO provides others, and we'll also examine one of them today.

In virtually every hearing we have held to date, we've asked our witnesses to comment upon the role of Congress. We've received a variety of helpful responses from people who have not studied the issue.

Today, we hope to explore the issue with witnesses who have had either practical experience with congressional oversight, or who have studied the issue. They have written distinguished articles on the subject. We look forward to their testimony.

Thank you very much for your participation today.

I would like to ask the members of the first panel, Mr. Paul Adams, Mr. Charles Dempsey and Mr. Frederick Kaiser, if they would please come forward.

As it has been our practice in the Banking Committee, would you raise your right hands.

Whereupon, Paul A. Adams, Charles L. Dempsey, and Frederick M. Kaiser, were called as witnesses herein, and having been first duly sworn, were examined, and testified as follows:

Senator **Graham**. Thank you, gentlemen.

Mr. Adams, do you have a statement?

STATEMENT OF PAUL A. ADAMS, INSPECTOR GENERAL, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, WASHINGTON, DC

Mr. **Adams**. Yes, sir. If I could summarize that and submit my written testimony for the record.

I enjoyed your remarks today. I think they're very, very impressive.

I also find it ironic that today commemorates the onset of this series of hearings when I first appeared before the House on May 8, 1989.

My remarks this morning are meant to stress the importance and the need for congressional oversight and hopefully I can provide you with some insight as to what has historically happened at HUD.

First of all, I'd like just to comment that since the passage of the Inspector General Act until the time that the HUD scandal broke on May 8, 1989, we had only been called on four occasions to testify before a congressional oversight committee. Those were before a variety of committees. But since the release of the Moderate Rehabilitation Report on May 8, 1989, I and my staff have testified on 12 different occasions before this and other committees of the Congress concerning the situation at HUD. I might add that most of the programs that were discussed during those hearings were troubled much before then and were reported by us as being troubled before that time.

Since becoming the Inspector General of HUD, I've had the occasion to prepare and submit to the Congress 10 semiannual reports. Those reports were made available to the oversight committees, the subcommittees' chairmen as well as the ranking minority members as well as the General Accounting Office, the public, the media and others. And there was little, if any, reaction to those reports.

We had attempted, apparently unsuccessfully, to highlight the conditions at HUD by summarizing those in the opening of the report. And let me just cite a few examples of those, if I might.

On page 1 in the executive summary of our 15th Semiannual Report to the Congress, we pointed out that the Department had made only limited progress in evaluating of its accounting and financial management controls as required by the Federal Managers' Financial Integrity Act.

In that same report, I reported that fraud and abuse in the Single Family Mortgage Insurance Programs was also a significant problem. We identified equity skimming and loan origination schemes as the two primary schemes involved. I might add that in each subsequent report, I've highlighted that as a continuing problem in the Department.

More recently, in report No. 20, we examined the multifamily section 223(f) Coinsurance Program, and estimated that defaulted loans could result in losses totalling nearly $700 million.

These are but a few examples of the recurring problems reported by us during those periods. Unfortunately, those messages were continually unanswered by anyone, either the Congress, the media or others.

On March 30 of this year, I appeared before this subcommittee to discuss the Department's role in the Federal Managers' Financial Integrity Act. It appears that those reports, like our semiannual reports, were not used to effect the needed improvements. I believe that the inaction with respect to those reports and our semiannual reports contributed to the problems that are now confronting us as a Department.

Based on the experience we acquired through this process, working with my staff, we have hopefully taken an arm's length reassessment of our own role to try to determine how we can more effectively communicate both with the Congress and others.

Today, as a matter of routine, we interface with Congress not only in a testimonial basis, but by conferring with committee chairs, such as yourself and your staffers in informal settings to try to keep you abreast of events at HUD. We have also broadened the distribution of our semiannual report to all members of all oversight committees and subcommittees as well as any other member of the Congress who is interested in a particular matter. We've attempted to further enhance that dialogue by convening a briefing of the committee staffers at the same time as the Secretary sends our report forward to the Congress. That's been rather successful. We're in the process of scheduling such a briefing at the end of this month when the next semiannual report comes out.

If the question, Mr. Chairman, is should there be better oversight over Departments, Agencies and Inspectors General, the answer is obviously, yes. I might add that Congress, when it enacts legislation and mandates reporting requirements should, at a minimum, read the reports and provide some oversight. Without such oversight, there is no accountability or followup. Without oversight, report preparation becomes a staff intensive paperwork exercise that benefits no one.

In conclusion, I'd just like to read you a closing paragraph of my upcoming message to the Congress in our next semiannual report:

> The past 15 months have been hectic ones. Many lingering problems have been acted on by Secretary Kemp and Congress. New problems are being addressed, and systems are in place to take corrective actions and instill accountability. I find this refreshing. I also believe the HUD scandals have been the impetus for much needed oversight by the Congress, not just of HUD but of other departments and agencies as well. Such oversight is essential if Inspectors General are to be successful in their legislated mission. I welcome this oversight and hope that Congress continues to exercise this important role.

I'd just like to emphasize how important I think the oversight role is.

That concludes my remarks, Mr. Chairman.

[The complete prepared statement of Paul A. Adams follows:]

STATEMENT OF
PAUL A. ADAMS, INSPECTOR GENERAL
U. S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
BEFORE THE HUD/MOD REHAB INVESTIGATION
SUBCOMMITTEE OF THE COMMITTEE ON BANKING,
HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
MAY 8, 1990

Mr. Chairman and Members of the Subcommittee, thank you for inviting me to appear before you today to discuss Congressional oversight. I find it ironic that today, May 8, commemorates the 1 year anniversary of the beginning of the intense scrutiny by Congress on HUD's plagued programs. We testified at that time on the Section 8 Moderate Rehabilitation Program before the House Subcommittee on Employment and Housing.

My remarks this morning concerning Congressional oversight, are meant to stress its importance and need. Hopefully, I can provide this Subcommittee with my insights as to what the facts have been as they relate to HUD and my office. My comments should neither be construed as blaming nor condemning because I think there has been too much finger pointing already. I am looking forward to a constructive session.

Historically, Congress has figured importantly in the oversight of HUD programs and operations. However, such oversight of the Department, until recently, was done without utilizing the work of our office. This has resulted in oversight being inconsistent and ineffective. For example, from the time the Inspector General Act was passed in October 1978 until the

"HUD Scandal" broke in April 1989, there were only four times where Congress took an active oversight interest in the work of our office. The work of an Inspector General's office is an important tool for Congress and OMB, as well as Agency management, and should be used. Before discussing this further, I will briefly summarize my appearances prior to the HUD scandal.

My first appearance was before the House Subcommittee on Housing and Community Development on February 4, 1986. In that hearing I was asked to discuss some of the significant problems that our office identified in our 14th Semiannual Report to Congress for the 6-month period ending September 30, 1985. These included: the HUD Single Family Insured Loan Programs dealing with equity skimming and loan origination fraud; rental assistance programs, specifically tenant fraud issues, and the Section 8 Moderate Rehabilitation Program.

In June 1986, we were asked to testify before the House Committee on Ways and Means, regarding HUD's proposal to require states to make quarterly wage data available for use in verifying individual eligibility for rental assistance payments. This proposal, which was subsequently enacted, enabled the Department to undertake a computer matching program to better address the proper expenditure of HUD rental assistance payments.

Later that summer, on August 4, 1986, I again testified before the House Subcommittee on Housing and Community Development about our audit reports on the Cuyahoga, Ohio Housing Authority. Two summers later, in August 1988, I appeared before the House Subcommittee on Employment and Housing. At that time, we made our findings known about HUD's participation in "Stroyindustria, '87." This was my fourth and final appearance prior to last May 8. Yet, in that same period of time, we issued 21 Semiannual Reports to the Congress highlighting significant problems and abuses of HUD programs and operations.

Since our Section 8 Moderate Rehabilitation reports were published a year ago, my staff and I have testified 12 times on the various problems at HUD. I might add that most of the programs did not become troubled in early 1989, but had been reported as troubled by our office for years.

Since becoming the HUD Inspector General, I have had the opportunity to prepare and issue ten Semiannual Reports, to the Congress. Each report was made available to all Oversight Committee and Subcommittee Chairmen and Ranking Minority Members as well as GAO, the media, OMB, etc. Yet, there was never any reaction to these reports by any of these recipients, until one year ago.

IN ORDER TO HIGHLIGHT HUD'S MOST SIGNIFICANT PROBLEMS WE WOULD SUMMARIZE THESE ACTIVITIES IN THE EARLY PART OF OUR REPORT. IN THE OPENING OF EACH OF OUR REPORTS, WE SUMMARIZED THE MOST SIGNIFICANT AUDIT AND INVESTIGATIVE EFFORTS IN THE FIRST FIVE PAGES. IN THE BODY OF THE REPORT THE DETAILS OF THESE ITEMS WERE FULLY DESCRIBED. OUR REASON FOR SUMMARIZING THE MOST SIGNIFICANT ITEMS IN THE FIRST FEW PAGES WAS TO BRING CONGRESS' ATTENTION TO THE PROBLEMS.

- ON PAGE 1 IN THE EXECUTIVE SUMMARY OF OUR 15TH SEMIANNUAL REPORT TO CONGRESS, WE POINTED OUT THAT THE DEPARTMENT MADE ONLY LIMITED PROGRESS IN EVALUATING OF ITS ACCOUNTING AND FINANCIAL MANAGEMENT CONTROLS AS REQUIRED BY THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT AND OMB CIRCULARS A-123 AND A-127.

- IN THIS SAME REPORT, AGAIN ON PAGE 1, FRAUD AND ABUSE IN THE SINGLE FAMILY MORTGAGE INSURANCE PROGRAMS WAS ALSO REPORTED AS A SIGNIFICANT PROBLEM. IT IDENTIFIED EQUITY SKIMMING AND LOAN ORIGINATION SCHEMES AS THE PRIMARY CULPRITS IN THIS PROGRAM. I WOULD ADD THAT EACH SUBSEQUENT MESSAGE TO THE CONGRESS HIGHLIGHTED THE CONTINUING PROBLEMS IN THESE PROGRAMS.

- HUD's Multifamily Section 223(f) Coinsurance Program was highlighted in Semiannual Report No. 20 for the 6-month reporting period April 1 - September 30, 1988. We reported that defaulted loans under this program could possibly result in losses totalling nearly $700 million to HUD.

These are but three examples of recurring problems within the Department that have been reported during my tenure and still in need of improvement. In our last Semiannual Report (No. 22), I stated that "the success of the corrective actions underway will depend largely upon the cooperation of the Congress, HUD management and career staff, and our office."

These Messages continually went unanswered by Congress, the media and the public. Oversight, based on our reported problems, was nil. Hopefully, today's hearing will discuss this failing, along with potential recommendations to correct any shortcomings.

On March 30, 1990 I appeared before this Subcommittee to discuss HUD's reporting under the Federal Manager's Financial Integrity Act. Prior to the 1989 report we had to force the Department to report accurately its problems to the Congress.

These program weaknesses should have been additional red flags to the Congress that HUD was experiencing serious management problems. However, it appears that these reports, like our Semiannuals, were not read or used to effect needed improvements. I believe this inaction allowed HUD's problems to perpetuate and grow to the point of scandal as we all have seen.

In recent months, my senior staff and I have taken hopefully an objective "arms lengths" look at our own operation to determine how we can be more effective as well as how we can better carry our message. This was a direct consequence of the events of the past year and the number and frequency of demands placed on our office.

Today, as a matter of routine, we interface with Congress not only in a testimonial capacity, but by conferring with Committee and Subcommittee Members and staffers in informal settings to keep them abreast of our ongoing activities. For example, we have broadened our distribution of the Semiannual Report to all Members of Oversight Committees as well as to Members where they have a particular interest in a matter. I believe this is further enhanced by our holding briefings for all interested Committee/Subcommittee staffers at the time our report is transmitted to the Congress by the Secretary.

THE QUESTION OF MORE CONGRESSIONAL OVERSIGHT HAS BEEN RAISED EVER SINCE HUD BECAME FRONT PAGE NEWS. IF THE QUESTION, MR. CHAIRMAN, IS SHOULD THERE BE BETTER OVERSIGHT OVER DEPARTMENTS, AGENCIES AND INSPECTORS GENERAL, THE ANSWER IS YES. CONGRESS, WHEN IT ENACTS LEGISLATION AND MANDATES REPORTING REQUIREMENTS, SHOULD AT A MINIMUM READ THE REPORTS AND PROVIDE SOME OVERSIGHT. WITHOUT SUCH OVERSIGHT, THERE IS NO ACCOUNTABILITY OR FOLLOW-UP. WITHOUT OVERSIGHT, REPORT PREPARATION BECOMES A STAFF-INTENSIVE, PAPERWORK EXERCISE THAT BENEFITS NO ONE.

TODAY, WE DISCUSSED REPORTS REQUIRED UNDER THE INSPECTOR GENERAL ACT AND THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT. BOTH REPORTS WERE INTENDED BY CONGRESS TO PROVIDE "RED FLAGS" FOR IT TO CARRY OUT ITS OVERSIGHT ROLE. YET, THESE REPORTS HAVE NOT BEEN USED. THIS MUST CHANGE. IN MY UPCOMING MESSAGE TO CONGRESS IN OUR SEMIANNUAL REPORT, I CLOSE WITH THE FOLLOWING REMARKS --

> "THE PAST 15 MONTHS HAVE BEEN HECTIC ONES. MANY LINGERING PROBLEMS HAVE BEEN ACTED ON BY SECRETARY KEMP AND CONGRESS. NEW PROBLEMS ARE BEING ADDRESSED, AND SYSTEMS ARE IN PLACE TO TAKE CORRECTIVE ACTIONS AND INSTILL ACCOUNTABILITY. I FIND THIS REFRESHING. I ALSO BELIEVE THE HUD SCANDALS HAVE BEEN THE IMPETUS FOR MUCH NEEDED OVERSIGHT BY THE CONGRESS -

NOT JUST OF HUD, BUT OF OTHER DEPARTMENTS AND AGENCIES AS WELL. SUCH OVERSIGHT IS ESSENTIAL IF INSPECTORS GENERAL ARE TO BE SUCCESSFUL IN THEIR LEGISLATED MISSION. I WELCOME THIS OVERSIGHT AND HOPE THAT CONGRESS CONTINUES TO EXERCISE THIS IMPORTANT ROLE."

THANK YOU FOR YOUR ATTENTION. I WOULD BE GLAD TO TAKE ANY QUESTIONS.

Senator **Graham**. Thank you very much, Mr. Adams.

Mr. Dempsey.

STATEMENT OF CHARLES L. DEMPSEY, FORMER INSPECTOR GENERAL, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, WASHINGTON, DC

Mr. **Dempsey**. Mr. Chairman, thank you for inviting me to appear here today to discuss congressional oversight or, in HUD's case, congressional undersight.

I'm now in my sixth year of retirement and I have paid close attention to the HUD hearings and other HUD problems.

I have no statement this morning, but I hope I can say some things and make some recommendations that will make for a constructive hearing.

Thank you, Senator.

Senator **Graham**. Thank you very much, Mr. Dempsey.

Mr. Kaiser.

STATEMENT OF FREDERICK M. KAISER, SPECIALIST IN AMERICAN NATIONAL GOVERNMENT, CONGRESSIONAL RESEARCH SERVICE, LIBRARY OF CONGRESS, WASHINGTON, DC

Mr. **Kaiser**. Mr. Chairman, thank you for the opportunity to comment on the theme of legislative oversight of administration in general and on the specific relationship between the statutory IG's and the Congress in particular.

The present IG's are relatively new creations, the IG in HUD, for instance, created in 1978. The subcommittee inquiry has been prompted by a recent financial scandal, exacerbated by lack of administrative control and communication. Nonetheless, the underlying issues reflect historical concerns. Writing in defense of the Constitution more than 200 years ago, James Madison alluded to these. He said:

> If men were angels, no Government would be necessary. If angels were to govern men, neither external nor internal controls on Government would be necessary. In framing a Government which is to be administered by men over men, the great difficulty lies in this: you must first enable the Government to control the governed; and in the next place, oblige it to control itself.

Madison was alluding here to the checks and balances system between the executive and the legislature, in particular. But he could have had an office of inspector general in mind. Indeed, under the Articles of Confederation, Congress had created, by law, an inspector general for the American Army. He had impressive audit and investigative authority and reported directly to the Continental Congress.

Now, of course, we have a new generation of offices of inspector general that exist in 60 Federal Departments and agencies. And these offices have impressive and independent authority to conduct investigations and audits within their own establishments. They also have important reporting obligations to Congress. That is what I'd like to focus on, some of the suggestions and options that are available for Congress to improve communication with the IG's, especially through the reporting requirements, not only the formal ones but the informal understandings as well.

Indeed, the whole idea of reporting requirements is seen in the 1978 act as one of the keystones to Congress' relationship and one of the three reasons why IG's were created in the first place.

The act calls for IG's to provide "a means for keeping the head of the establishment and the Congress fully and currently informed about problems and deficiencies relating to the administration of such programs and operations and the necessity for and progress of corrective action."

That is part of the purposes for the IG's when they were created in 1978.

Also, the act specifically calls for, of course, semiannual and the immediate or specialized reports to go to the agency head who then must transmit them to Congress, in most cases without any alteration or deletion.

The act also provides that Congress can call upon the IG's and upon information from the IG's, not only through these required reports, but also through other means, and "otherwise," such as testimony at hearings or direct contact between the two.

For good measure, the 1978 act also adds that "nothing in this section or in any other provision of the act shall be construed to authorize or permit the withholding of information from Congress, or from any committee or subcommittee thereof."

So, again, a very real concern is evident in the 1978 act for gaining information, allowing Congress a number options separate from the semiannual reports and the immediate or specialized reports.

The ideal of the inspector general keeping the establishment head and Congress fully and currently informed about problems and deficiencies, however, must be viewed in light of the reality of the office's resources, capabilities and statutory authority, as well as Congress' own interest and structure. Several options can be examined in this light. These options recognize that communication between the IG and a Congressional panel is a two-way process and that the absence of communication sends signals, even though they may be unintended and unwanted.

One important issue to look at is to clarify the language in the law that calls for immediate reports to the agency head for "particularly serious or flagrant problems, abuses and deficiencies." These immediate reports, which are sent to the establishment head, then are to be transmitted to Congress within 7 days. However, that provision has rarely been activated. In the first 8 years of the IG act, 1978 to 1986, the House Government Operations Committee found that on only eight occasions, had that provision been activated, and that was done by six Inspectors General.

The absence of these immediate reports is, in part, due to the vagueness of the statutory language. It is neither defined in the law nor directly commented upon in the accompanying committee reports. This may be a reflection of the realities of the situation in 1978 when the act was passed. At that time, there was a massive financial scandal that engulfed the General Services Administration, and that provided the catalyst for passage of the law. Two years earlier, actually in 1976, when the first contemporary statutory IG's were created in the Department of Health, Education and Welfare, now Health and Human Services, there was also a major scandal that involved fraud in Medicare and Medicaid programs;

and it could be that in hindsight anyway, the problems of this magnitude were initially seen as constituting particularly serious or flagrant problems and abuses. This view, in turn, could have set the precedent for future non-reporting under the provision or the absence of reports under this provision.

In any event, whatever the reasons, there are steps that can be taken to help clarify the meaning of this language. One would be to ask GAO, the General Accounting Office, to examine the rare actual use of this provision, determining what specific problems, abuses, and deficiencies activated it. Another part of this study by GAO could look at the other side of the coin, that is, why did IG's not report particular wrongdoing which later clearly seems to fall under the category of particularly serious or flagrant problems.

Congress could examine GAO's findings in light of the President's Council on Integrity and Efficiency's recent Suggested Criteria and Procedures for Early Warning Notifications. These are a useful first step in the right direction. Indeed, they recognize problems inherent in trying to set uniform standards for what may not be comparable problems among different departments and agencies, or among different types of programs.

However, the guidelines and criteria that were issued by PCIE harbor their own problems. One of them was the use of the word "egregious" to connote serious or flagrant problems. The word "egregious" seems to have a higher threshold, another meaning, than just simply serious or flagrant problems.

In conjunction with the PCIE criteria and the GAO analysis, Congress might look at the Justice Department guidelines for parallel matters. For instance, it might be useful to consider differences among levels and different types of investigations that the Justice Department undertakes or to consider what factors and criteria result in a preliminary investigation, for instance, and which ones cause it to expand or expire.

In addition to these, Congress might want to compare the IG reports to the Attorney General, when there are reasonable grounds to believe that there has been a violation of Federal criminal law. These reports, incidentally, don't go to the agency head automatically, or to Congress; they go to the Attorney General directly. Some of these violations conceivably constitute serious or flagrant problems.

A broader theme that I'd like to pursue, briefly, is the communication between the IG's and the congressional committees. Formal lines of communication are fairly well established under the law and under the reporting provisions of the 1978 act, as amended. In fact, in 1988, they were given a lot more detail and some additional teeth were put into those 1988 amendments. But they could be supplemented by more frequent and regular contact between the IG and congressional committees and subcommittees. Relying on the infrequent reports about serious problems and the semiannual reports is insufficient for being kept currently and fully informed.

Indeed, the Inspector General Act anticipated that these two formal reporting mechanisms would be insufficient. That is why the 1978 act explicitly authorizes Congress and its panels to call upon the IG's through other means, "and otherwise," in the language of the law. One of these techniques, of course, is to examine

IG reports regularly and routinely, at the end of each month, for instance, rather than waiting for their summary statement or a list of them in the semiannual report. Again, the semiannual report may only tell the committee or subcommittee about what had happened 7 months before, because of the delay in the submission of the report to Congress. This kind of an exchange, looking at the reports on a more routine and regular basis, not only benefits Congress by giving it more timely information, but it also enhances the worth of the IGs' product.

A staff person might be designated to handle this responsibility, as well as to maintain liaison with GAO, CRS and the other congressional support agencies.

Also the committee and subcommittee requests to the IG for investigations or audits and follow-up inquiries into IG specific recommendations are other techniques which could increase communication and improve congressional oversight capabilities. These kinds of requests alert the IG about which programs relevant congressional panels consider important or about which programs they have received complaints and criticisms.

This type of direct request and followup would also help to alleviate a concern about complacency that could arise over certain expectations associated with offices of inspectors general. Ironically, Congress may become complacent regarding its own oversight responsibilities in light of the statutory IG's substantial independence and impressive audit and investigative powers. If this occurs, Congress delegates its oversight responsibilities.

An unintended consequence of this situation might be a signal to the IG or program officials in the agency that Congress is unconcerned about suspected abuses, deficiencies or other problems. Rather than being seen as a favorable response to an IG's capabilities, paradoxically, such complacency could undercut an IG's independence and influence to the extent that they depend upon the support of the Congress.

Connected with this is an intangible factor and that is the desirability for IG's, themselves, to recognize that their relationship with Congress, through formal and informal lines of communication, is an important part of their independence. Admittedly, IG's are placed in a difficult situation. They are designed to serve two masters: the Executive and Congress. But all Executive agencies created by public law have that same dilemma. The IG's have it to a greater extent than others.

First of all, IG's are mandated to keep Congress and the agency head fully and currently informed about the problems and deficiencies. Putting this into effect might require more initiative on the part of some IG's, through improved semiannual reporting, greater use of immediate reports, and more timely direct contact with committees and subcommittees, than they have demonstrated in the past.

Second, without this kind of information or because of its delayed arrival, Congress is unable to make use of the IG's findings and recommendations. This in turn could send the wrong signal back to the agency, one that appears to under value the IG's work and thus erode the IG's stature within the establishment.

Thank you, Mr. Chairman.

[The complete prepared statement of Frederick M. Kaiser follows:]

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

STATEMENT BY FREDERICK M. KAISER

BEFORE THE

SENATE SUBCOMMITTEE ON HUD INVESTIGATIONS

MAY 8, 1990

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to comment on the theme of legislative oversight of administration in general and on the relationship between the statutory offices of inspector general (IG) and Congress in particular.

The present IG offices are relatively new--the IG in the Department of Housing and Urban Development was created in 1978, for instance--and this Subcommittee inquiry has been prompted by a recent financial scandal, exacerbated by a lack of administrative control and communication. Nonetheless, the underlying issues reflect historical concerns. Writing in defense of the Constitution more than 200 years ago, in the Federalist Papers (No. 51), James Madison alluded to these:

> If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary. In framing a government which is to be administered by men over men the great difficulty lies in this: you must first enable the government to control the governed; and in the next place, oblige it to control itself.

The "father of the Constitution" was providing a rationale for the system of checks and balances; but he could have been referring to the role of inspectors general. Indeed, Congress, operating under the Articles of Confederation, had created "inspectors-general" in the American Army during the Revolutionary War, resolving that they were "essential . . . to the reformation of the various abuses which prevail in the different departments . . ." These officers were granted independent investigative and audit authority along with direct reporting obligations to the Congress. They were empowered "to receive the complaints and representations of both soldier and officer, and [to transmit] to Congress what petition and grievances he shall think worthy of notice." They were also authorized to examine "from time to time the pay-books of the respective regiments . . . giving immediate notice to Congress of any malversation or mismanagement which he may discover." (Journals of Congress, v. 2, Dec. 13, 1777. p. 372-373)

CURRENT STATUTORY OFFICES OF INSPECTOR GENERAL

Statutory offices now exist in 60 Federal Departments and agencies. They were established with substantial bipartisan support in both Chambers of Congress, often in the face of opposition from the affected agencies. [1] The contemporary effort to create statutory IGs---that is, permanent, independent, and objective units which would consolidate authority for audits and investigations within a Federal establishment--began in 1976, with the creation of such an office in the Department of Health. Education and Welfare (now Health and Human Services). Similar offices were included in the Departments of Energy and Education when they were erected in the late 1970s and have since been added in a piecemeal fashion elsewhere--in the Departments of Defense and State, for instance, through authorizations.

Two major enactments--the Inspector General Act of 1978 and its 1988 Amendments--however, established the majority of these offices and standardized the powers, duties, and responsibilities of the IGs. The generic Inspector General Act of 1978 (5 U.S.C. Appendix) set up offices in twelve departments and agencies, including the Department of Housing and Urban Affairs, and provided for the basic authorities, responsibilities, and purposes of the IGs.

---

[1] U.S. Congress. House. Committee on Government Operations. The Inspector General Act of 1978: A 10-Year Review. House Report No. 100-1027, 100th Congress, 2d Session. Washington, U.S. Government Printing Office, 1988. p. 1-8 and 29.

A decade later, the 1988 Amendments to the Inspector General Act (P.L. 100-504; 102 Stat. 2515-2532), extended such offices to the few remaining Cabinet Departments and major agencies without them, standardized their powers and authorities, added specific items to the reporting obligations of the IGs and the head of the establishment, and created a new set of IGs for smaller Federal entities. Presently, all statutory IGs operate under the 1978 Act, as amended (except for the new IG in the Central Intelligence Agency, authorized separately in 1989.)

Under the 1978 Act, as amended, all the Departments and largest Federal agencies have IGs who are nominated by the President and confirmed by the Senate, and who can be removed only by the President. The IGs are to be selected without regard to partisan affiliation and on the basis of integrity and demonstrated ability in accounting, auditing, financial analysis, law, management analysis, public administration, or investigation. Further supporting their independence, the IGs are precluded from assuming "program operating responsibilities;" and now, all have a separate appropriations account. The IGs, moreover, serve only under the "general supervision of the head of the establishment." Neither the head nor any other official in the agency, moreover, can "prevent or prohibit the Inspector General from initiating, carrying out, or completing any audit or investigation, or from issuing any subpena during the course of any audit or investigation." (Exceptions to this rule under the 1978 Act, as amended, exist only for the Departments of Defense, Justice, and Treasury, and then, only for certain specified reasons.)

The inspectors general have been granted impressive authority "to promote economy, efficiency, and effectiveness in the administration of, and to prevent and detect fraud and abuse in [the establishment's] programs and operations." These include the power to:

- --conduct audits and investigations throughout their respective establishments;
- --have direct access to all information, documents, records, reports, audits, and reviews throughout the establishment;
- --issue subpoenas under their own authority for information and documents;
- --receive complaints from employees;
- --administer oaths for taking testimony;
- --have direct and prompt access to the head of the establishment;
- --hire and control their own personnel and resources; and
- --request assistance directly from any Federal, State, or local government agency.

REPORTING TO THE ATTORNEY GENERAL

Inspectors General are directed to "report expeditiously to the Attorney General whenever the Inspector General has reasonable grounds to believe there has been a violation of Federal criminal law." This provision arose because the referral process from agencies to the Justice Department had been viewed "as slower and more cumbersome than necessary," according to Justice Department testimony on the 1978 enactment. 2/ The directive was designed to require the IG to make prompt and direct referrals to the Justice Department. This would occur "without clearing referrals with the agency head, the General Counsel of the agency, or any other individual in the agency." 3/ Unlike other specific

---

2/ U.S. Congress. Senate. Committee on Governmental Affairs. Establishment of Offices of Inspector and Auditor General in Certain Executive Departments and Agencies; Report to Accompany H.R. 8588. Senate Report No. 95-1071, 95th Congress, 2d Session. Washington, U.S. Government Printing Office, 1978. p. 30.

3/ Ibid.

reporting obligations under the 1978 Act, consequently, the IG is not required to notify either the establishment head or Congress of such matters.

REPORTING TO THE ESTABLISHMENT HEAD AND CONGRESS

Under the 1978 Inspector General Act, as amended, IGs are required to keep the head of the establishment and Congress informed by means of specific reports--semiannual and immediate reports--and otherwise. Indeed, one of the three principal purposes in creating the statutory IGs, as called for in the 1978 Act, is:

> to provide a means for keeping the head of the establishment and the Congress fully and currently informed about problems and deficiencies relating to the administration of such programs and operations and the necessity for and progress of corrective action.

Semiannual Reports

The IG's semiannual reports are required to include, but are not limited to: a description of significant problems and abuses, recommendations for corrective action and progress on them, a summary of reports made to the establishment head, and a listing of each audit report, along with detailed statistics, data, and information about costs associated with them. The IG reports go to the head of the establishment. The head issues his own report, containing any comments "he determines appropriate," along with required information and statistical tables on costs and corrective actions, among other matters.

The semiannual reports from the IG and establishment head are to be transmitted by the head to the "appropriate committees and subcommittees of Congress" within thirty days. Except under unusual circumstances, the head "may not generally prevent the [IG] report from going to Congress or alter or delete the report," according the Senate Governmental Affairs Committee account of this provision. 4/ The panel added that this protection is fundamental to the independence and integrity of the IG. That is because the IG, in carrying out its mandate,

> may also discover information which reflects adversely on high agency officials, including the agency head. For this reason, this provision contemplates that the [IG] reports will ordinarily be transmitted to Congress without alteration or deletion. This requirement is fundamental to the legislation; it provides the foundation of the [Inspector General's] independence. 5/

Nonetheless, competing concerns were raised by the Justice Department at the hearings on the 1978 Act; these focused on the possible disclosure in IG reports of information that might compromise ongoing criminal investigations or privacy rights of individuals, or reveal grand jury or tax return information--that is, information, "the disclosure of which is improper under the law" and which could "subject the [IG] to legal sanction." 6/ The Senate panel "recognize[d], however, that in rare circumstances the [IG], through inadvertence or design, may include in his report materials of this sort which should not be disclosed even to Congress." 7/ "In this kind of rare case," the Committee noted, the transmittal requirement--for the head to transmit the IG report to Congress and later to make it available to the public--is "not intended to prohibit the agency head from deleting the materials in question." 8/

4/ Ibid., p. 2.

5/ Ibid., p. 31.

6/ Ibid., p. 32.

7/ Ibid.

8/ Ibid.

Sixty days after being sent to Congress, the IG's semiannual report is to be made available to the public. In part because of this availability, the 1978 IG Act provides that "nothing in this section shall be construed to authorize the public disclosure of information" which is otherwise prohibited by law, specifically protected from disclosure by an executive order, or part of an ongoing criminal investigation. A caveat exists, however, to the broad restrictions for the last category: "any report under this section may be disclosed to the public in a form which includes information with respect to a part of an ongoing criminal investigation if such information has been included in a public record."

Immediate Reports Concerning Particularly Serious Problems

In addition to the semiannual reports, each IG "shall report immediately to the head of the establishment involved whenever the Inspector General becomes aware of particularly serious or flagrant problems, abuses, or deficiencies relating to the administration of programs and operations of such establishment." The head, in turn, "shall transmit any such report to the appropriate committees or subcommittees of Congress within seven calendar days," together with a report "containing any comments he deems appropriate." Neither the law itself nor the accompanying congressional committee reports contain a definition or description of what constitutes "particularly serious or flagrant" problems.

Other Information Provisions

Two other sections of the Inspector General Act affect the IG's responsibility to keep Congress and the establishment head informed. Most importantly, one of the IGs duties is "to keep the head of such establishment and the Congress fully and currently informed, by means of the reports required in section 5 [semiannual and immediate reports] and otherwise, concerning fraud and other serious problems, abuses, and deficiencies . . . " (Emphasis added.) Incorporating the words "and otherwise," the Senate Governmental Affairs Committee instructed, "makes clear its intention that Congress is not limited to the information conveyed in the semiannual reports . . . The relevant committees and subcommittees of Congress will undoubtedly be calling the [IG] to testify about the issues within his domain." 9/

For good measure, the 1978 Inspector General Act adds that "nothing in this section or in any other provision of this Act shall be construed to authorize or permit the withholding of information from Congress, or from any committee or subcommittee thereof."

OPTIONS FOR IMPROVING IG REPORTING AND CONGRESSIONAL OVERSIGHT

The ideal of the inspector general keeping the establishment head and Congress "fully and currently informed about problems and deficiencies" must be viewed in light of the reality of the office's resources, capabilities, and statutory authority as well as Congress' structure and interest. Several options that might improve inspector general reporting to Congress and congressional oversight relate to these characteristics. These options also recognize that communication between the IG and a congressional panel is a two-way process and that the absence of communication sends signals, even though they may be unintended or unwanted.

9/ Ibid., p. 28.

Clarifying "Particularly Serious or Flagrant"

Immediate reports are to be sent to the establishment head when the IG discovers "particularly serious or flagrant problems, abuses, or deficiencies." Evidently, however, this provision has been rarely activated. Indeed, a survey by the House Government Operations Committee found that by 1986, eight years after passage of the generic Inspector General Act, only six IGs had made such reports, and only eight reports had been sent. 10/

The absence of these immediate reports is, in part, due to the vagueness of the language; it is neither defined in the law and nor directly commented upon in the accompanying committee reports. It may also be a reflection of the early history of the inspectors general. When the 1978 IG Act was being considered in Congress, for instance, a massive financial scandal engulfed the General Services Administration and provided a catalyst to passage of the law; two years earlier, fraud in medicare and medicaid programs provided the catalyst to the establishment of the first of the contemporary statutory IGs in HEW. 11/ It could be that only problems of this magnitude were initially seen, mistakenly or not, as constituting "particularly serious or flagrant" problems and abuses; this view, in turn, could have set the precedent for future (non)reporting under the provision.

10/ House Government Operations Committee, The Inspector General Act of 1978: A 10-Year Review, p. 22-23.

11/ Ibid., p. 1-9. See also, Senate Governmental Affairs Committee, Establishment of Offices of Inspector General, passim; U.S. Congress. House. Committee on Government Operations. Establishment of Offices of Inspector General in Certain Executive Departments and Agencies; Report to Accompany H.R. 8588. House Report No. 95-584, 95th Congress, 1st Session. Washington, D.C., U.S. Government Printing Office, 1977. p. 4-6; and U.S. President, 1977-1981 (Carter). Inspector General Act of 1978; Remarks at Bill Signing Ceremony. Public Papers of the Presidents, 1978. Washington, D.C., U.S Government Printing Office, 1979. p. 1755.

In any event, certain steps could be taken to help clarify the meaning of the language and better equip the IGs to put the provision into operation. One would be to request that the General Accounting Office (GAO) examine the (rare) actual use of this provision, determining what specific problems, abuses, and deficiencies activated it. GAO could also examine situations in which IGs did not immediately report wrong-doing that, at least in hindsight, appeared to meet a common understanding of "particularly serious or flagrant" problems.

Congress could then examine the GAO findings along with efforts of the executive in this and related matters. Recently, for instance, the President's Council on Integrity and Efficiency (PCIE) developed "Suggested Criteria and Procedures for Early Warning Notifications." 12/ These appear to be useful steps in the right direction; they recognize, for instance, problems inherent in trying to set uniform standards for what may not be comparable problems among different departments and agencies or among different kinds of programs. These suggested criteria, however, reveal a problem of their [illegible] In stating the early warning goals, the criteria call for the IG to alert the administration to "major problems which . . . represent egregious waste, fraud, abuse or mismanagement." 13/ "Egregious," however, connotes a more exacting standard--a higher threshold--for notification than does "particularly serious or flagrant."

In conjunction with the PCIE suggested criteria, Congress might look at the Justice Department guidelines for parallel matters. For instance, it

---

12/ U.S. President's Council on Integrity and Efficiency. Suggested Criteria and Procedures for Early Warning Notifications. Washington, D.C., Office of Management and Budget. February 26, 1990.

13/ Ibid., Attachment, p. 1. See also, House Government Operations Committee. The Inspector General Act of 1978: A 10-Year Review, p. 22-23.

might be useful to consider differences among levels of investigations or to consider which factors and criteria result in a preliminary investigation and which ones cause it to expand or expire.

Along with these, Congress might want to compare IG reports to the Attorney General when there are reasonable grounds to believe there has been a violation of Federal criminal law. Some of the suspected violations, conceivably, consititute "serious or flagrant" problems and abuses in an agency. 14/

Communication Between the IG and Congressional Panels

Formal lines of communication are fairly well-established through the reporting provisions in the 1978 IG Act, as amended. But they could be supplemented by more frequent and regular contact between the IG and congressional committees and subcommittees with jurisdiction over the establishment and its programs. Relying on the infrequent immediate reports about serious problems and the semiannual reports is insufficient for being kept "currently and fully informed." For instance, the semiannual report might only notify Congress about a problem that is already seven months old. (Notification about a problem uncovered at the beginning of the six-month reporting period is delayed another month while the establishment head prepares his report.)

The Inspector General Act, however, anticipated that the two formal reporting mechanisms would not be sufficient. The 1978 Act, therefore, explicitly authorizes Congress and its panels to call upon the IGs through other means--"and otherwise," in the language of the law. One of these

---

14/ See House Government Operations Committee, The Inspector General Act of 1978: A 10-Year Review, p. 27-28.

techniques is to examine completed IG reports regularly and routinely--at the end of each month, for instance--to determine if any is relevant to ongoing committee inquiries or appears to if a program harbors serious problems which might require immediate attention. A related approach is to examine the individual IG reports at the beginning of all congressional oversight and authorization efforts; that way, any relevant IG findings and recommendations can be incorporated into the process when they are likely to have the greatest impact--at the beginning. This exchange not only benefits Congress, by giving it more timely information; but it also enhances the worth of the IG's product.

A staff person might be designated to conduct this survey and serve as liaison with the office of inspector general. (The same person might also maintain contact with congressional support agencies, particularly GAO and the Congressional Research Service, to find out about their recent studies in the area.) The staffer would benefit from training and expertise in auditing, accounting, or investigations, among other areas, to deal with the separate IG audits and investigative reports as well as the semiannual reports.

Committee or subcommittee requests for IG investigations or audits and followup inquiries into IG recommendations are other techniques which could increase communication and improve congressional oversight capabilities. Such requests also alert the IG about which programs relevant congressional panels consider important or about which programs they have received complaints and criticisms.

This type of direct request and followup would also help to alleviate a concern--about complacency--that could arise over certain expectations associated with offices of inspector general. Ironically, Congress may become complacent regarding its own oversight responsibilities, in light of the statutory IGs' substantial independence and impressive audit and investigative authority. If this occurs, Congress delegates its oversight function. An unintended consequence of this situation might be a signal to the IG or program officials in the agency that Congress is unconcerned about suspected abuses, deficiencies, or other problems in the programs and operations. Rather than being seen as a favorable response to an IG's capabilities, paradoxically, such complacency could undercut an IG's independence and influence, to the extend they depend upon support from Congress.

Connected with this is an intangible factor: that is, the desirability for inspectors general to recognize that their relationship with Congress--through formal and informal lines of communication--is an important part of their independence and reputation. First of all, the IGs are mandated to keep Congress "fully and currently informed about problems and deficiencies relating to the administration of [the establishment's] programs and operations and the necessity for and progress on corrective action." Putting this into effect might require more initiative on the part of some IGs--through improved semiannual reporting and more frequent direct contact with committees and subcommittees--than they have demonstrated in the past. Secondly, without this information or because of its delayed arrival, Congress would be unable to make use of an IG's findings and recommendations. This, in turn, could send the wrong signal back to the agency--one that appears to undervalue the IG's worth--and thus erode the IG's stature within the establishment.

Senator GRAHAM. Thank you very much, Mr. Kaiser.

Mr. Adams, you mentioned in your statement that, prior to last year, you had been called upon relatively infrequently as part of congressional oversight. I think you indicated only one time had you been asked to testify on your semiannual report.

Is that correct?

Mr. ADAMS. That's correct, sir.

Senator GRAHAM. Mr. Dempsey, during your period as Inspector General, what was your experience in terms of being questioned by Congress to report on your semiannual or other reports?

Mr. DEMPSEY. Never, sir. I never received as much as a phone call. And if I may say, Mr. Chairman, at that time, between 1981 and 1984, we investigated the HUD Undersecretary, the Assistant Secretary, the Deputy Assistant Secretary, and three regional administrators. Action was taken against all. We received very heavy publicity in the Washington Post and other papers around the country. And I still didn't receive one call. It was reported to the Congress in the semiannual reports but it was also with heavy publicity. I never received a call from a congressional committee.

Senator Graham. What steps did you take during that period, Mr. Dempsey, in order to bring your findings to the attention of Congress?

Mr. DEMPSEY. Just what the IG act said I should, Public Law 95-452, the semiannual reports. Now, there should be, as Mr. Adams pointed out and I think Mr. Kaiser, also, there should be much closer, a two-way street, not a one-way street. I received calls from many reporters over the past year asking me just this very question. And I said, go get the 21 IG reports from 1978–1989 and read them. And in every instance, there was a report in the Washington Post, in the New York Times, in the St. Louis Post Dispatch, in the Dallas Times Herald. Once they read the reports, they said the information was there; that nobody in the Congress was reading or paying attention.

Senator GRAHAM. Mr. Adams, what steps did you take to bring to the attention of the Congress the findings that you had unearthed?

Mr. ADAMS. My reactions were similar to those of Mr. Dempsey. The semiannual reports. We had some infrequent discussions at the staff level with the committees. There was no expression of interest on their part in the issues. We have since recognized that we should have taken a much more aggressive role. The staffers have become much more receptive. I hope that relationship will continue.

But I think Mr. Kaiser made the point that it has to be a two-way relationship, so unless we get some feedback, I think we sense a lack of interest. We can only do so much.

Senator GRAHAM. The semiannual reports are, as a matter of course, sent to the Congress. Are there any other of your specific program reports that have been sent to Congress?

Mr. ADAMS. I'm not aware of others, Mr. Chairman. We at the present time have a relationship with the House Subcommittee on Employment and Housing. We provide to them at the beginning of each week, all the reports issued in the previous week, at their request, much along the lines that Mr. Kaiser recommended, on an on-going basis.

Senator **Graham**. Mr. Dempsey.

Mr. **Dempsey**. I have to say one other thing, sir.

A year ago, more than a year ago actually, it was August 4, 1988, the House Subcommittee on Government Operations held a 10-year review of Inspectors General. At that time, I was asked to give some testimony. There were three points I made. The third point, I said to the then chairman, I hope the Appropriations and Oversight Committees of both the Senate and the House really take the time to read and absorb the semiannual reports of the Inspectors General. I didn't mean just the HUD Inspector General, I meant all of them. I said, overall I thought they were pretty good and they tell what's going on. And that I sometimes felt, as an outsider, that the newspaper reporters did a better job of reading the IG reports than the congressional oversight committees.

Senator **Graham**. One of the concerns raised is that sometimes the executive summaries of the reports are written in sufficiently vague language or words that tend to connote a sense of control so as to diminish the congressional recipient's sense of urgency.

Do you believe that there is a method in which your reports could be restructured in order to more explicitly bring to the attention of the Congress a serious problem?

Mr. **Adams**. Earlier in 1986, I had changed my foreword to a Message to the Congress in which I attempted to highlight with as much precision as possible the problems that we detected during the preceding period. I also tried to provide some balance in that message as to the actions the Department was taking or was committed to taking at that point. Based on the more recent hearings, we've reassessed that and we've tried to reformat our report prospectively. I think you will detect a substantial change in our most recent report, Mr. Chairman.

Mr. **Dempsey**. Mr. Chairman, I never read an audit or an investigative report that I couldn't in my own mind maybe want to change and make a little better. But I never read one over say 28 or 30 years that I didn't ask the question, did you do this, or why didn't you do that. So it's something that everyone can do as we review these.

But I went back over those 21 semiannual reports and I looked at Mr. Adams' report No. 17 from May, 1987. And it's got a message on the top, "the Inspector General's Message to Congress." And he says this: Four items deserve particular attention.

Senator **Graham**. Excuse me. The date of this report is?

Mr. **Dempsey**. This is May 1987.

In the second paragraph, he says, four items deserve particular attention. The first is Single Family Mortgage Insurance Fraud. We have discussed this in prior reports but our work indicates it is still a significant problem across the nation.

Now, I didn't feel, after reading that, that Mr. Adams had to come up here with a red flag and wave to you people. He called it. This is open and shut.

He also went on to say that the second major item is the HUD Subsidized Section 235 Loan Program. The HUD subsidy outlay could be reduced by $844 million, that's loans with high interest rates, to refinance at current rates. And I don't think he even got a phone call.

So the question is, there's got to be a two-way street. The IG says, here it is. And I don't know that anybody ever read it. And I have a list of the people that he sent it to, and it'll embarrass people if I read the names.

Senator **Graham**. Having said that, Mr. Dempsey, do you have any recommendations of how that two-way street in terms of clarity of communication could be enhanced, other than encouraging a course in reading. [Laughter.]

Mr. **Dempsey**. There's got to be, as I said, a two-way street, and staffers have to take the time to read it. But at the same time, the IG is going to have to come up here and sit down with staffs and say, this is the situation, this is what I'm going to report, this is what this means.

Remember, this is a combination of audits and investigations; nothing is drier than audit reports. And you're trying to put all this information together in accordance with Pub. L. 95–452, the IG Act. And really, you're talking complex programs, you're talking programs that take people many months and years to become specialists in. And you've got to sit down and talk these things out. And there has to be interest on this side.

I frankly will tell you that I thought no one up here gave a darn as to what was going on. That was my impression. Mr. Adams and I have talked about this. When I was the Inspector General and he was the Deputy Inspector, this is something we talked about. We wondered, what do we have to do. Because, remember now, the IG works for the Executive Branch of Government; he does not work for the Congress. He reports to the Congress, and I felt, we reported to the Congress. But I think I would like to see a hearing each time that IG sends that report up. Just come up for an hour and talk about what it is, get it on the record. Let the press be there and hear it.

The press, there was one reporter for the Washington Post whose name was Kurtz who read these religiously. I think he paid his mortgage off our reports for a few years, but he did his homework. And I often said, if he can read it, why don't the staffers read it. They're the ones with oversight responsibility.

Senator **Graham**. I think each of you has alluded to one of the provisions that's in the law, the so-called 7 day letter. Mr. Kaiser, you indicated in your survey, that that 7 day letter process had not been used very extensively. Is that correct?

Mr. **Kaiser**. That is correct. In fact, it was the House Government Operations Committee report that Mr. Dempsey just mentioned, that included a study that found it was used on only eight occasions by six different IG's in the first 8 years of its existence. That's once a year.

Indeed, some of the suggestions that we've just heard here, the question has to be asked, then: why would some of these abuses that were found by the IG's not be reported through that mechanism? This might give us a good concrete illustration of why it's difficult to use that kind of mechanism, because it clearly does alert Congress to a very significant problem. It's hard to ignore those 7 day reports or 7 day letter reports.

Senator **Graham**. The law states that each Inspector General shall report immediately to the head of the establishment involved whenever the Inspector General becomes aware of particularly serious or flagrant problems, abuses or deficiencies, relating to the administration of programs and operations of such an establishment. The head of the establishment shall transmit any such reports to the appropriate committees or subcommittees of Congress within 7 calendar days, together with a report by the head of the establishment to obtain any comments that such head deems appropriate.

Mr. **Dempsey**. Mr. Adams, did you ever consider utilizing that 7 day report process on the circumstances that you were uncovering at HUD? I did not have, from 1978 under the Carter administration and in the 4 years under the Reagan administration, I did not have one instance of one particularly flagrant problem that I could say, hey, this is it. There were many times that I would say to our auditors, I want you to hurry up; this looks like a hot one. I want you to hurry up and finish it because I want it in the semiannual report.

The act also says that there must be a back and forth relationship between the Secretary and the IG. He must have access. I had access. Whenever I had something on an individual that was in the hands of the Justice Department and usually I referred it as soon as possible, I would let the Secretary know and we'd handle it that way. But that's not a 7 day report.

I think the 7 day report is very important. I think it should be clarified and I wish someone could change the act and maybe put some specifics in there. It's hard for me to say but when Mr. Adams went on to say we have a significant problem, this is a significant problem, he's already reported it. How many times do we have to report significant problems?

Now, if you were to say on audit follow-up, or on significant problems, if they've been reported twice before, then automatically a 7 day report comes up on the problem or automatically, if you find out that a HUD senior official who promised to do something on an audit recommendation last year and failed to do it, if you want to make that 7 day, fine. But set out the criteria and let them come out with it. It might stop some of this nonsense.

Senator **Graham**. Mr. Adams.

Mr. **Adams**. I, like Mr. Dempsey, have gone through this process several times, to assess what is appropriate under the criteria. It's very difficult.

The audit and investigating process is not a short term thing. Quite often, the revelations or disclosures would coincide with the reporting period and we'd use that mechanism.

In the Mod Rehab situation, I believe we assessed the possibility with staff several times, that we would have had a 7 day report. Had Secretary Kemp not taken the actions that he took at that point, I think that would have been cause for a 7 day report. However, it was only at the time that I gave him the report that we had the complete story. And to trigger a 7 day report prior to that would have been premature. We also had the consideration of the on-going criminal investigation still under consideration by the Department of Justice.

So I think there are a lot of factors that enter into that decision in the process, and it's one that should be thought out before implementation.

Senator **Graham**. Mr. Kaiser, do you have any further comments on the 7 day report?

Mr. **Kaiser**. Just to echo some of the notions that have been developed here, and to emphasize that there are attempts to better-define and put this requirement into operation. Again, the PCIE has been working on this; as a matter of fact, I think, since 1986, they've been working on this very problem. And it's the kind of thing that perhaps your subcommittee could make a recommendation to the full committee or indeed to the Governmental Affairs Committee, since it has general responsibility for the IG act; this would bring to bear not only some of the congressional thoughts on this, but also from other agencies, including the executive branch, such as the PCIE or the Justice Department, helping to define that language.

It is very vague and indefinite, but that provision potentially is a worthwhile one, if it can be put into operation. We, again, have seen examples where it could have alerted Congress more rapidly and gotten better attention, than, again, simply relying on the semiannual reports.

Senator **Graham**. At a hearing before the Senate Governmental Affairs Committee, the Inspector General for the Department of State, Mr. Funk, suggested that the reason why the 7 day letter was not used was out of a concern that it was the ultimate weapon, the hole card. And if it were to be played and received no reaction from Congress, that the Inspector General would have no fall back position.

Is that expression by the Department of State Inspector General one in which you have sympathy or empathy?

Mr. **Dempsey**. I do. I feel back in the times, had I done something like that, it might very well have happened that the Congress would say, ho hum, and not have even looked at it. That was my perspective. Perhaps on the Senate side, I would have gotten some attention; I'm not sure of the House side.

Mr. **Adams**. Mr. Graham, I might add that the study that Mr. Kaiser referred to earlier, eight were reported. I don't know of any actions that were taken with respect to those reported.

Mr. **Dempsey**. I don't think anything was done.

Senator **Graham**. We've now been through an even 365 days of the HUD scandal. How ironic, we're meeting today on the anniversary of your first testimony on this, Mr. Adams. Some of the most recent testimony has been given before Congressman Lantos' committee by Mr. Gilliam, reporting a series of instances in which he states that funding decisions were made on political bases, rather than a serious effort to determine the need and merit of the application.

Were either of you aware of that process of political decisionmaking within HUD programs?

Mr. **Adams**. No, sir, not at that time. In retrospect, many of the audit reports that we issued, and I think Mr. Gilliam identified some of those in his testimony, detected process problems but we could not get to the underlying motivation for the decisions. It's only through the testimony of parties to the transaction that such a thing is disclosed.

Mr. **Dempsey**. No particular problems. But I wrote an article for Government Executive Magazine called "Formula For Scandal," where I pointed out that over the 30-year history of HUD, scandals in HUD were like the locusts plagues; you had one every 6 or 7 years. HUD has been treated by the Congress as a political football. Very political programmers and developers and people doing business in the industry and indeed the industry, itself, have used the Congress as a manipulator and vice versa.

And I felt that the Congress knew well, because they were behind the majority of these schemes, just exactly what was going on in HUD. We were reporting on the audits and investigations, but nothing came from this that is the Congressional side of the fence.

Senator **Graham**. If you had become aware of the kinds of things that Mr. Gilliam is now alleging occurred, do you feel that you could have gone to Secretary Pierce with that information?

Mr. **Adams**. If there was no indication the Secretary would have been implicated, I would have gone to the Secretary. I might just refresh the Congress' memory by pointing out that my staff did the investigation that resulted in the conviction and imprisonment of Mr. Gilliam. And I took that, with the concurrence of the Department of Justice, to the Secretary. At that point, I had no reason to believe that the Secretary was involved. So I think there are situations in which it's totally appropriate to take it to the Secretary or head of the agency.

Senator **Graham**. In some of our earlier hearings, it had been suggested that there were some quantifiable signals that were coming out of the Department that might have raised suspicions as to what was happening under the service. For example, the Moderate Rehabilitation Program which had been originally targeted at relatively smaller developers, and a few number of units, was being transformed into a larger unit process; the change in the administration of the program from a decentralized program with a fair share allocation to a highly centralized program, and; the fact that an inordinate number of units seemed to be assigned to a limited number of locales in several instances, those being areas that already had an over supply or at least an adequate supply of the same kind of housing that Mod Rehab was intended to provide.

Do you think that there are some quantitative screens that could be established, or have any in fact been established, that would complement and supplement the traditional audit examinations as indicators of program performance?

Mr. **Adams**. Yes, sir.

I might just point out that many of the factors you just articulated are exactly the same ones that came to our attention and served as the basis for the work that we undertook concerning the Moderate Rehabilitation Program. That's part of the normal audit planning process, the gathering of that kind of information from various sources, and making a decision as to what we will be auditing. And many of those factors were exactly what drove us to do the audit work that we did.

I might point out that an elapsed time of about 15 months was required to do that work, and required a total expenditure of about 18 staff-years. So it was no small task to do the program we did. And, as subsequent hearings revealed, there was much more that we didn't even pick up in the course of the work that we did.

Senator **Graham**. What are the differences between your kind of review and what would probably be one of the closest analogies in the private sector, which would be an independent CPA who comes into a business to do a review? Is it that, whereas the business is essentially evaluated by its financial performance, with a Government agency you don't have that profit and loss line; therefore you have to evaluate performance in terms of the achievement in an efficient and effective manner of the goals for which the department or a specific program within that department was established.

In the lead-in rationale for the establishment of the Inspector General office, the Statute says that to provide leadership and coordination of recommended policies for activities designed to, a) promote economy, efficiency and effectiveness in the administration of such programs that are the responsibility of that department.

How do you carry out that function? That is, to be able to tell the Secretary and then tell the Congress that the Moderate Rehabilitation Program, which had the foregoing set of congressional objectives, has achieved those objectives or has fallen short of those objectives?

Mr. **Adams**. First of all, we're not capable just because of capacity, of auditing each and every program each year. So we have to go through a planning process and an evaluation to determine which programs we will choose to audit. There are many criteria involved in that selection process, including Congressional interest, monies appropriated, the newness of the program, the last time the program has been audited, to name only a few. Then we must look at the legislative history of the statute itself, and articulated the objectives. Quite often we find that sometimes those are not very clear and are quite difficult to comprehend.

Our auditors and our evaluators' perceptions of those objectives and the program official's are sometimes in conflict with each other as we get further into the process. And many of the programs are evolutionary, they're not passed in one moment in time, but they're later modified and amended. And it's quite difficult to comprehend that.

I think the work that we did on the Moderate Rehabilitation Program is a good example of such an effort and the controversies that can evolve from the discussions. The waiver by the Congress of the fair share allocation process was just typical of the kind of amendments that are made midstream in the program quite often, and make the ability to comprehend it that much more difficult.

Senator **Graham**. What I'm interested in is, if taking the Moderate Rehabilitation Program, if it had as an initial objective, rehabilitating 40,000 units at an average cost of $8,500, do you monitor whether in fiscal year 1990, in fact, there were 40,000 units being rehabilitated and what the average cost of that rehabilitation is?

Mr. ADAMS. Not necessarily. It would depend on our selection process because we might in one year look at one program and in another year, look at another program.

Senator GRAHAM. Why aren't those kinds of, what I call, quantifiably verifiable facts, that don't require the traditional auditing process, but are a matter of gathering in an organized manner data as to what in fact occurred against program's goals. Why couldn't that be done on an on-going basis even for those programs that you did not determine that in that particular year you would do an in-depth audit?

Mr. ADAMS. I think more typically that's done through the authorization and appropriations process. The departments and agencies' report the prior year's accomplishments. That's all part of that normal budgetary submission to Congress, which is information that we also use in the evaluation of things that we are doing, particularly audit work.

Senator GRAHAM. Mr. Dempsey.

Mr. DEMPSEY. The IG does the internal audits, the program audits. You mentioned could something be done similar to what the Big Eight firms do in accounting and things of that nature.

Senator GRAHAM. No. I was drawing a distinction that the Big Eight firms in fact report essentially the same ultimate answer because they report profit and loss. The distinction I was drawing was that HUD doesn't have, doesn't make a profit or doesn't incur a loss in the sense that generally accepted accounting procedures would define a loss. The functional equivalent of that profit and loss report is whether the agency, in an effective and efficient manner, accomplished its objective.

Mr. DEMPSEY. Carrying out the extent of the legislative intent.

Senator GRAHAM. So I'm asking, just as a CPA firm would report the ultimate answer, was this firm profitable or unprofitable, would it not be appropriate for the IG's report to include the program accomplishment data for the programs under the department that was the responsibility of the Inspector General?

Mr. DEMPSEY. I'm not sure that's the intent of the IG legislation. I'm not sure that's the job for the IG. But there is legislation on this Hill in front of another Senate committee, recommending or about to recommend a chief financial officer in every department and agency. I think that chief financial officer should have a small internal audit group of his or her own to handle just exactly what you say. Then the IG will have the oversight to see whether that's done. I would very much like to see that legislation on the chief financial officer go through, very much indeed.

Senator GRAHAM. We've been joined by our ranking member, Senator Mack. I have just a couple of more questions to ask. Then I will turn it over to Connie for his questions of this panel.

Mr. Kaiser, you mentioned the fact that there is now a proposal from the President's Council on Integrity and Efficiency, the PCIE, for an early warning system directed at the Office of Management and Budget. That report uses, as you indicated, the term, "egregious" waste, fraud or mismanagement and significant loss of funds.

My question is, if the 7-day letter criteria, which appears to be less demanding than "egregious waste," has generated so few reports and such little congressional response, what is the sense that this new process would have a better one?

Mr. **Kaiser**. It's an interesting question, because the evidence we have is somewhat contradictory. Under those guidelines, as I understand them, OMB accumulated the information it sent to the Hill recently about some high risk programs; 106 programs were identified in hearings by Senator Glenn's Committee on Governmental Affairs a few months ago, and those high risk programs or vulnerability programs, I think, came out of this PCIE assessment.

So if that's the evidence, if that's correct, those programs were identified through that process. Then you would think they would also have had to have been identified then through the semiannual letter or reports. I'm a little uncertain about the background of that information, and whether or not PCIE and OMB, when they accumulated these data and identified these high risk programs, used this specific criterion, or not. If they did, one would assume that these also would meet the threshold for particularly serious and flagrant problems.

Mr. **Adams**. I might clarify that if I could, Mr. Graham.

I believe that the 106 material weaknesses that Mr. Kaiser refers to are those things which are normally reported by the Federal Managers Financial Integrity Act, and not the revelations of the Inspector General.

Mr. **Dempsey**. Mr. Chairman, it must be remembered that in 1982, when the Financial Managers Act was passed, that material weaknesses were to be reported to OMB each year. If you look at the past 3 to 4 years, in each of those years the HUD employees reported material weaknesses and nothing was done about it, either by OMB or by the Department. So to use OMB as another place to do this is fine. But who's going to check to see whether OMB's going to do the job?

Senator **Graham**. If that early warning system that's been recommended by the Council is put into effect, do you believe that this notice, which is going to go to the agency head and OMB, should also go to Congress?

Mr. **Dempsey**. Surely, by all means.

Senator **Graham**. Mr. Adams.

Mr. Adams. Yes, sir.

Senator **Graham**. Mr. Kaiser.

Mr. **Kaiser**. I would agree.

Senator **Graham**. My final questions would go back to some of the earlier discussion about comments made by Mr. Gilliam when he testified last week before the House committee. He said that he diverted technical assistance funds to field offices in order to avoid detection of abuses by the Inspector General because the IG had fewer resources in the field than they did in the central office.

Were you aware of these allegations, of HUD management attempting to circumvent your responsibility?

Mr. **Adams**. First of all, a point of clarification. I have more staff at the field level than I do at headquarters, Mr. Chairman. I found it rather amusing when he made that statement.

I'd also like to clarify what his statement was, that he reprogrammed from technical assistance to special projects in trying to disguise the monies he was sending out. I don't think in any way we lack any capacity or lack any numbers overall in the organization to address all the problems of the Department.

Last year, the Congress authorized an additional 33 staff-years for our organization, but unfortunately, because of Gramm-Rudman-Hollings and some other situations, the money could not support those positions. So I wasn't able to fill them. I have a continuing concern that both my organization and the Department, as a whole, lack the staffing to carry out the very large mandate of the Department.

Mr. **Dempsey**. Mr. Chairman, I'm not surprised at anything Mr. Gilliam said. I didn't know Mr. Gilliam that well, but you must remember that Mr. Adams and his staff were the ones who put Mr. Gilliam in the slammer.

Senator **Graham**. With that statement, I reluctantly conclude with this final question. Mr. Gilliam testified that the Inspector General had nowhere to turn with his concerns and recommendations, since HUD management had been unresponsive and Congress was more interested in getting its projects funded under the very programs that the Inspector General was criticizing.

Do you agree with that assessment by Mr. Gilliam, taking into account his veracity?

Mr. **Adams**. I tend to agree with him, but Mr. Gilliam shared with us and the public as a whole a lot more information than was previously available to us. Had we known some of those things, I would suspect that we'd have had a lot more investigations ongoing. There were some startling revelations in his testimony.

Senator **Graham**. In fact, do you intend to pursue any of the areas that he has recently illuminated?

Mr. **Adams**. Yes, we are. We're consulting with the Department of Justice to be sure that all those areas are covered.

Senator **Graham**. Senator Mack?

Senator **Mack**. Thank you, Senator Graham.

First of all, I apologize for not being here through your entire testimony and questions and answers. I have a brief opening statement for the record and then I'd like to ask the witnesses a few questions. I hope that I will not drag you through the same thing that Senator Graham did with the questions that he's already raised.

OPENING STATEMENTS OF SENATOR CONNIE MACK

Following today's hearing on congressional oversight, Secretary Jack Kemp will testify in the final hearing for this subcommittee's investigation of HUD. Secretary Kemp will comment on current activities at the Department of Housing [HUD]. Today's hearing, therefore, is the final opportunity we will have to examine past policies that led to so many problems at HUD.

I think it is appropriate that we examine the role congressional oversight, or the lack thereof, played in the problems we have seen at HUD. In fact, it may be one of our more important hearings.

The reason I say this is because congressional oversight responsibilities should in general force Congress to examine its own policies and the extent to which they may invite abuse. As I said during the hearing on executive oversight, I believe a good law is not only one which allows good people to do good things, but one which prevents bad people from doing bad things.

I think it is the consensus opinion that most lawmakers and their staffers [not to mention those in the executive branch] are so busy that oversight responsibilities have largely been neglected. I have been in Congress long enough to know that things don't happen unless you force them to happen. If this means scheduling more hearings specifically on oversight, then that is what we ought to recommend. Ultimately, Congress must take responsibility for making sure the laws it enacts are working.

I guess maybe the place that I would start is, how independent are you? And I raise that from the perspective of what it must be like. By way of background, I spent 16 years in the banking business and I had both internal controllers trying to keep an eye on the operations of the bank that reported to me, and I had audit committees of the board that were interested in those reports; the fact that the cashier of the bank also was given the responsibilities of audit and reported to me, and so when he would come in to make his presentation of his findings, there was a tendency, I think, for the auditor, the cashier and the president to look at those issues that were raised from one perspective, where it might be viewed by the audit committee from a different perspective.

That raises in my mind that you must find yourselves in a very similar situation where you have pressure from management, if you will, in essence that says, we don't like the way you've worded this particular statement with respect to the problem you've identified, and we'd like for you to change it. Is that a problem?

Mr. **Adams**. There will always be a certain amount of tension between the Inspector General and the management of the Department or agency, but I don't consider that to be unhealthy. I think that tends to be checks and balances to the process.

As to my personal perception of my independence, I think you're just as independent as you perceive yourself. In my particular situation, when I took the position succeeding Mr. Dempsey, I would be eligible to retire before the change of administration occurred. And I knew if I felt any extraordinary pressure, that was an option available to me. I had originally contemplated retiring a year and a half ago but decided to stay as this thing started evolving. As far as actual pressures, I felt none at all, other than those I imposed on myself to do a good job.

Mr. **Dempsey**. I never had a problem with independence. When you sit down with the Secretary—and I sat down with three HUD Secretaries—and read them this portion of Public Law 95-452, when I said that, "neither the head of the establishment, meaning the Secretary, nor the officer next in rank below, shall prevent or prohibit the IG from initiating, carrying out or completing any audit or investigation or from issuing any subpoena," their eyes narrow and they look at you differently than other persons at the staff table. That's normal. But when you do it properly and you run a fair program and tell every assistant secretary you are independent, and you act that way, you don't have any problems. I never did.

Senator **Mack**. So you don't think there's anything, none of you feel there's anything that we need to do?

Mr. **Dempsey**. Not in that area.

Mr. **Adams**. Mr. Mack, I think some people have suggested that the Inspectors General should have tenure, a term appointment. That has been an issue that the Congress, several times in the recent past, has considered. I'm rather ambivalent on it, myself. I have no strong urges for it, but I'd just bring that to your attention as one way of ensuring independence.

Senator **Mack**. My instinctive reaction is you're really saying that that's really not necessary.

Mr. **Dempsey**. I don't think so. Either the IG has the guts or he or she doesn't. And tenure's not going to make them do their jobs properly.

Senator **Mack**. I understand, though, that the Secretary of the Department does determine any bonuses given to the IG. Is that right?

Mr. **Adams**. First of all, I disqualified myself from receiving bonuses. I could not, in good conscience, accept an award from the person I could potentially have to investigate.

Mr. **Dempsey**. In 1981, I gave Mr. Pierce a letter saying that I could not work for him and investigate him and take a bonus from him. I gave it to him the day after I was appointed.

Senator **Mack**. I commend the attitude of both of you, and would just ask one further question along that line. Is that a pretty universal attitude among the Inspectors General?

Mr. **Dempsey**. I can't say. I don't know, sir.

Mr. **Adams**. I have no personal knowledge, Mr. Mack.

Senator **Mack**. I guess really the only other area I want to pursue has to do with the reports, themselves, in the sense, is there any question in your mind that the Congress should have picked up much earlier and responded to those reports? I mean, was the wording clear enough in those, to us to say, there's a major problem down there; we should be acting, we should have acted sooner?

Mr. **Dempsey**. I felt that the reports were clear.

As I mentioned before in answer to a question from Mr. Graham, I gave four or five reporters this recommendation, "Look at the 21 IG reports and then judge them. All of these reporters, from the Washington Post, New York Times, Dallas Times Herald, and the St. Louis Post Dispatch, once they read them, said the warnings were there. Senator Proxmire, last year, said the same thing. He said, "We missed it; the warnings were there and we missed it." I think the IG did its job!

Mr. **Adams**. I would agree, Mr. Mack. In fact, a couple of former congressional staffers have commented to me that they knew this all along. Maybe they had the intuition but not the facts. We often find ourselves perceiving things as a potential problem but not having the facts to back those up. But I think the reports told the story.

Senator **Mack**. Are there any second thoughts you might have, for example, with coinsurance? And I don't have the exact details in front of me, but in essence, rather than to include the wording of the concerns in the executive summary, your feelings about coinsurance were in fact in the body of the report?

Again, I don't think anybody should take the position of a defense that says you didn't put it in the executive summary; I just failed to read the rest of the report. But that is a way through the auditing process, is to put that in the executive summary. It becomes something that just jumps right out at you.

Any second thoughts about that?

Mr. **Adams**. I've had some second thoughts about the whole process, and have tried to improve the quality of the report. And I think the more recent reports will reflect that. But as we've testified earlier, we've also taken some additional initiatives. We've scheduled briefings with the committee staffers to coincide with the release of the report. That was done the last time the report was put out. It will be done again later this month.

We'll invite all committee staffers on all the oversight committees, both the House and the Senate, to join us. We'll sit them down, walk them through the report, respond to any questions that they have. That's just another means of hopefully getting information back to people such as yourself and the chairman who provide that oversight you feel that we need, or that we feel that you need to provide us.

Senator **Mack**. Let me just kind of set a scenario and see how it would work out.

You and I get together. I'm the head of the agency. We get together and you raise some concerns. I'm pretty forceful in getting you to modify a statement that you felt strongly about but after we had some give and take, decided that you were going to go, and in good conscience go with the position that I had staked out. Would you feel any hesitancy at some subsequent point when you were meeting, let's say, with the staffs and going through this report, to raise that concern, you know, that there was this difference of opinion? We did state it this way but there's something still gnawing at you.

In other words, I guess what I'm saying is, is there the opportunity to provide personal input beyond what is in that report?

Mr. **Adams**. I believe so. I would make such a statement. I would place it in the context of the discussion that was held between me and the agency head, and be sure that the person understood that and not to be misperceived. I would find nothing wrong with that. It would be appropriate.

Mr. **Dempsey**. You're talking about an individual audit report, you're not talking about the semiannual report. The semiannual report they can't change. When you send it up, it stays that way. If they make a change in it, you report them. So far as I know, that's never happened to any IG.

On an individual audit report, you have a regular audit process. You do your audit, you have an exit interview, and you talk about what you found. You give them the draft report. They have so many days to comment on it. Then they send the draft report back and you put your final report together. So that everybody has a chance to have a say. Because the IG is just as much interested as anyone because the IG can make a very big mistake if he or she doesn't listen, and maybe the auditors have perceived the wrong thing. But if I feel strongly and I make no changes, I'll put the program's person's statement in the audit, but I leave what I wrote, as is, yes, sir.

Senator MACK. Thank you very much. As I said, I don't want to drag you back through the same things.

Senator GRAHAM. Thank you, Senator.

Thank you very much, gentlemen.

If the second panel could please come forward. Mr. Thomas Mann and Mr. Bert Rockman of the Brookings Institution, Mr. Stanley Brand, former General Counsel of the House, and Mr. Richard Wegman, chairman of the congressional oversight committee for the National Academy of Public Administrators, and former staff director of the Senate Government Affairs Committee, and Mr. Richard Fogel, Assistant Comptroller General of the GAO's agency management reviews.

Gentlemen, please stand and raise your right hands.

Whereupon, Richard L. Fogel, Stanley M. Brand, Richard A. Wegman, Thomas E. Mann, and Bert A. Rockman were called as witnesses herein, and having been first duly sworn, were examined, and testified as follows:

Senator GRAHAM. Thank you.

Gentlemen, we appreciate your assistance today. I will call on you in the order that you are listed on the witness list for any opening statements.

Mr. Fogel.

STATEMENT OF RICHARD L. FOGEL, ASSISTANT COMPTROLLER GENERAL, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, WASHINGTON, DC

Mr. FOGEL. Thank you, Mr. Chairman.

I'd like to submit my formal statement for the record, and summarize it.

Senator GRAHAM. Your statement, Mr. Fogel, and all statements will be incorporated right in the record. It will remain open for 30 days for any subsequent additions.

That statement is also applicable to panel 1.

Mr. FOGEL. Thank you.

Congressional oversight of executive agencies and programs can greatly enhance program operations by focusing on program and policy implementation. All too often, the focus in the executive branch and the Congress is on policy development. The executive branch officials are seldom selected because of their managerial backgrounds, and during their generally short tenures which average only about 2 years, they tend to measure their success by the policies they develop, rather than by how well they're carried out. Few direct their energies to the management issues facing their agencies. At the same time, congressional attention also is often on the development of legislation. Congressional oversight of implementation issues often occur only when things have reached crisis proportions.

Obviously, we at the GAO believe that more attention needs to be given to basic management issues facing our program agencies. All too often, we have found that our audits detect continuing management control weaknesses which were previously identified in our reports, those of congressional committees, inspectors general, and the agencies themselves.

Major breakdowns in management controls will continue to plague us until we give sustained attention to ensuring that the agencies have necessary mission planning systems to provide organizational direction; modern and accurate financial and management information systems to monitor operations; effective evaluation efforts to assess the efficiency and effectiveness of programs; and dynamic human resources programs which not only recruit and develop talented workers who are the key to an effective organization, but also very importantly have good mechanisms for holding managers accountable for results.

What are some of the key elements to good congressional oversight?

First, we believe it is important for Congress to engage in continuing dialog with agency political leadership over the future course of the agency. This dialog is essential to forming the basic consensus over agency goals which is critical for effective agency operations. Those agencies which operate with conflicting mandates often experience serious management problems.

Second, as problems with program implementation are identified, Congress needs to insist that agency officials develop plans and time tables for correcting the problems. Congress needs to closely evaluate the adequacy of the plans prior to accepting them. And once plans have been accepted, the authorizing and appropriations committees need to support the accomplishment of the plans through realistic funding decisions.

Third, Congress needs to make it clear to agency officials that they will be held accountable for taking effective corrective actions. Agency progress must be monitored on a continuing basis to ensure that resources are being used appropriately, milestones are being met, and agency plans remain realistic.

We at the GAO will continue to assist Congress in its oversight efforts. Through our program results reviews, we will continue to provide the Congress with reliable information on how agency programs are carried out. Through consultations with congressional committees, we will continue to plan our work so that we can provide our evaluations in a timely manner. Our goal is to develop strategic work plans in all our issue areas that reflect the key issues and concerns of Congress. That way, the information we provide can be most useful in the legislative process. Constant dialog between us and the committees is thus essential if we are to be responsive.

We need an iterative process where we come out and identify problems and issues and we get reaction from members and the staff, and develop a strategic work plan that provides you the information that you need.

We will also continue to urge passage of comprehensive financial management reform legislation. Developing modern information systems capable of providing accurate information to congressional and executive branch policymakers is fundamental to effective program management and oversight.

Finally, we will continue doing agency management reviews. These reports provide both Congress and the executive branch with the basis for a viable agenda for addressing agency management weaknesses in the context of achieving program objectives.

Agency leaders have found these general management review reports can help get the commitment necessary within their agency bureaucracies and within Congress to address difficult management issues.

Congress has reacted in an increasingly positive way to the reports, using them to conduct agency oversight. Some committees have specifically asked agency leaders to report on their efforts to address our recommendations. Others have used the reports as a tool for understanding agency management strategies and needs.

To the extent that Congress and agency leadership can agree on the priority management efforts needed, the chance for progress is enhanced. But unless the management issues are discussed in the context of achieving program objectives, we find that little is accomplished in terms of making improvements.

[The complete prepared statement of Richard L. Fogel follows:]

United States General Accounting Office

GAO

Testimony

For Release
on Delivery
Expected at
Tuesday
May 8, 1990
9:30 a.m. EDT

How to Enhance Congressional Oversight

Statement of
Richard L. Fogel, Assistant Comptroller General
General Government Division

Before the
Senate Committee on Banking
Subcommittee on HUD/Mod Rehab Investigations

GAO/T-GGD-90-40

GAO Form 160 (12/87)

Mr. Chairman and Members of the Subcommittee

I am pleased to be here today to discuss how congressional oversight of federal agencies and programs can be enhanced.

Diligent congressional oversight of executive agencies and programs can greatly enhance program operations by focusing on program and policy implementation. All too often the focus in the executive branch and Congress is on policy development. Executive branch officials are seldom selected because of their managerial backgrounds, and during their generally short tenures--averaging about 2 years--they tend to measure their success by the policies they develop rather than by how well they are carried out. Few direct their energies to the management issues facing their agencies. At the same time, congressional attention also is often on the development of legislation. Congressional oversight of implementation issues often occurs only when things have reached crisis proportions.

More attention needs to be given to basic management issues facing our program agencies. The serious problems our government faces today, including the breakdown in internal controls at the Department of Housing and Urban Development, the crises in the savings and loan industry and in our nation's nuclear production facilities, and the rising costs we face to modernize our air traffic control system, arose in part from our failure to pay adequate attention to the nuts-and-bolts issues of managing our government's programs effectively and preparing adequately for the future.

All too often, GAO's audits detect continuing management control weaknesses which were previously identified in our reports and those of Congress, Inspectors General, and the agencies themselves. How often have those reports been systematically analyzed and used as a basis for developing plans to improve agency operations?

Major breakdowns in management controls will continue to plague us until we give sustained attention to ensuring that the agencies have the (1) necessary mission planning systems to provide organizational direction; (2) modern and accurate financial and management information systems to monitor operations; (3) effective evaluation efforts to assess the efficiency and effectiveness of programs; and (4) dynamic human resources programs which not only recruit and develop the talented workers who are the key to any effective organization, but also have good mechanisms for holding managers accountable for results. Over the past decade, HUD experienced problems in all these areas which contributed to the fraud and waste found in the co-insurance, home financing, and moderate rehabilitation programs, and the breakdown in financial and fiscal controls over Federal Housing Administration (FHA) funds.

What are some of the key elements of good congressional oversight? First, it is important for Congress to engage in a continuing dialogue with agency political leadership over the future course of the agency. This dialogue is essential to forming the basic consensus over agency goals which is critical for effective agency operations. Those agencies which operate with conflicting mandates often experience serious management problems. For example, since the creation of the General Service Administration, there have been conflicting views on the best ways to provide the government's housekeeping services. Some see GSA's mission as one of setting policy and overseeing the operations of the executive branch agencies. Others have asserted that GSA can achieve the greatest efficiencies through controlled operations in the areas of common item procurement, space control, and surplus property transfers. These conflicting views have never been resolved, resulting in continuing criticism of GSA's performance from Congress and the federal agencies.

Second, as problems with program implementation are identified, Congress needs to insist that agency officials develop plans and time tables for correcting the problems. Congress needs to evaluate closely the adequacy of the plans prior to accepting them. Once the plans have been accepted, the authorizing and appropriation committees need to support the accomplishment of the plans through realistic funding decisions. Moreover, it should be easier to support agency funding decisions to solve agency management problems if they are made within the framework of an overall plan for the agency.

Third, Congress needs to make it clear to agency officials that they will be held accountable for taking effective corrective actions. Agency progress must be monitored on a continuing basis to ensure that resources are being used appropriately, milestones are being met, and agency plans remain realistic. The agencies must be convinced that they will not be able to just appear at one or two hearings, report on progress, answer several questions, and go their own way.

The struggle to improve program management is often a long, difficult, and thankless task, but Congress needs to persevere in its oversight efforts. It is inevitable that there will be times when there will be significant disagreements in objectives and approaches between the Congress and the executive branch. These must be worked through. Likewise, there will be other areas in which there will be disagreements within Congress on the appropriate direction of federal programs, and these must be reconciled as best as possible. And there may be charges that Congress is trying to micro-manage agencies. But effective, persistent oversight, designed to hold agency officials accountable for carrying out their own plans is not micro-management.

GAO will continue to assist the Congress in its oversight efforts. Through our program results reviews, we will continue to provide Congress with reliable information on how agency programs are carried out. Through consultations with congressional committees, we will continue to plan our work so that we can provide our evaluations in a timely manner. Our goal is to develop strategic work plans in all our issue areas that will reflect the key issues and concerns of the Congress. That way the information we provide can be most useful in the legislative process. Constant dialogue between us and the committees is thus essential is we are to be responsive.

Our work at HUD demonstrates the role congressional concerns play in our work plans. Consistent with congressional interest, we are placing more emphasis on a range of issues surrounding housing for the elderly, including the need for improved integration of housing and health care services for the low-income elderly. Our work on the impacts of making changes to the criteria used by the Federal Housing Administration to insure single family housing loans responds to congressional interest in receiving our analysis of strategies such as easing down payment requirements, raising FHA loan ceiling limits, and making flexible interest rate mortgages more available. We are also surveying the adequacy of HUD's oversight of the modernization program for public housing in recognition of congressional concerns relating to the controls over the more than $1.5 billion annually appropriated to this program.

We will continue to urge the passage of comprehensive financial management reform legislation. Developing modern information systems capable of providing accurate information to congressional and executive branch policymakers is fundamental to effective program management and oversight.

Finally, we shall continue doing agency general management reviews (GMRs). These reports provide both Congress and the executive branch with the basis for a viable agenda for addressing agency management weaknesses in the context of achieving program objectives. Agency leaders have found that the GMR reports can help get the commitment necessary within their agency bureaucracies and within Congress to address difficult management issues. Congress has reacted in an increasingly positive way to the reports, using them to conduct agency oversight. Some committees have specifically asked agency leaders to report on their efforts to address our recommendations. Others have used the reports as a tool for understanding agency management strategies and needs. To the extent that Congress and the agency leadership can agree in the priority management efforts needed, the chance for progress is enhanced.

That concludes my prepared statement. I would be pleased to answer any questions.

Senator **Mack**. Would you say that one more time for my benefit?

Mr. **Fogel**. Yes. Unless the agency management problems are really discussed in the context of trying to achieve program objectives, we find that generally management improvements don't take place.

In other words, you can't just talk about the need to get better financial management or hold program managers accountable to get a better program out that measures in the abstract. You have to relate it to programs that the agencies are responsible for.

And what we've found time and again is that neither the political leadership in the agencies nor the congressional committees, quite appropriately, are just interested in talking about management issues. It has to be put in the context of what are the programs trying to achieve. So it's a mistake just to come up and talk about good management. It's a little bit like talking about motherhood. Everyone thinks it's good, but unless you put it in the context of what are these agencies trying to do, you don't get very positive action.

Senator **Graham**. Mr. Brand.

STATEMENT OF STANLEY M. BRAND, BRAND & LOWELL, WASHINGTON, DC

Mr. **Brand**. Thank you, Mr. Chairman.

I don't have a written statement. I told the Staff last week, when they called and told me that there'd be a hearing today, that I could talk about congressional oversight in my sleep. Unfortunately, I've discovered since then that I cannot write in my sleep. I hope that means that my testimony won't be like what Sam Goldwyn said about oral contracts, that is, that they're not worth the paper they're written on.

My background is as general counsel to the clerk of the House in which I served as counsel to the House of Representatives in litigation and other matters arising from congressional oversight hearings. Since leaving Congress in 1983, I have represented a number of witnesses and entities before Congress conducting oversight investigations, including some Government agencies.

And I've even been asked to serve as consulting counsel to several Senate committees on oversight, including Senator Kerry's committee.

I don't make it a practice to lecture Senate committees about oversight, but I cannot talk about oversight without mentioning the constitutional underpinnings which oversight comes from and how important those are in recognizing what it is that you have set out to do. The oversight function is in the words of William Pitt, even to be preferred to the legislative function in which it adheres, if one goes back to the parliamentary roots, as I have, you'll see that the struggle between Parliament and the Crown over control of the fisc, control over money, was really a glorified oversight exercise.

It's the power of the purse that really defines the oversight function in the modern era, as it did in parliamentary times. Oversight has been with us since 1789 when the Congress flexed its muscles for the first time in the oversight arena in reviewing the failed St. Clair expedition under the Washington administration, and it's been going on ever since, by my count, some 600 times.

In the modern era with Watergate, the EPA, and the Iran-Contra hearings, it's reached a new level of activity.

Specifically turning to the issues before the committee, the impact that oversight can have on agencies and what conceivably could have gone wrong in this case, I would like to point out that I did not hear the Inspectors General talk about or refer to the sensitive issues that arise when Congress does involve itself in on-going Inspector General matters.

They are part of the executive branch, but, as the Supreme Court has instructed us, even the Department of Justice, which makes individual enforcement decisions, is subject to congressional regulation by legislation, and its decisionmaking is inevitably reviewed in the context of how those statutes are administered. So it is important, notwithstanding the separation of powers' problems, that are always present when Congress reviews the administration of existing laws by the executive branch agency, that those executive branch agencies are, themselves, creatures of statutes whose powers and duties are defined by law and defined by Congress.

Two specific issues that I thought were briefly addressed and that were raised with me by the staff and which I think are in our report are, number one, the impact of multiple committee jurisdiction over the subject matter of congressional oversight. There is, obviously, a natural tendency to competition among committees. I guess competition is generally a good thing because it brings out the best in everyone to be put in an arena where your own perspicacity and skills are being tested against those of others. In the congressional context, it has some particularly difficult ramifications.

First, because committee jurisdiction isn't parsed out precisely the way other governmental powers are, they're parsed out generally under the rules and the precision that you have in other areas doesn't exist. What clearly establishes committee jurisdiction isn't easy to determine, either. Many times, it's the first committee to the subject matter. It's often times hard and tedious staff work that produces that result. And so the rewards are reaped by a committee that's been diligent in pursuing its jurisdiction in an aggressive manner.

In the House of Representatives, for example, in 1974, the House mandated that every single standing committee have an oversight subcommittee whose responsibility was, on a continuing basis in the words of the rule, to review existing programs and the administration of existing statutes. That rule in concept is an excellent rule, and it has been used quite frequently by the House since the adoption of those rules. But like any rule, or any muscle, it atrophies if it's not used. And there are some committees that use it better than others.

The second problem in coordinating a committee oversight investigation with other committees that might have jurisdiction is, there's no real procedure or forum for resolving jurisdictional disputes. Sometimes the witnesses raise it as an issue, but they're not in a particularly good position legally to raise it. Because if the subject is pertinent in the law to the jurisdiction or line of inquiry of the committee in the most general kind of way, then their committee has jurisdiction from a legal standpoint. During the EPA controversy in the House, with which I'm very familiar, the Public Works Committee seized jurisdiction, rightfully seized jurisdiction over the matter and, as the oversight exercise developed, four other committees joined the ranks and complicated the pursuit of that investigation to some degree.

The fourth aspect is that good oversight is hard work and it's tedious and it doesn't always produce immediate results. It often is a long range, long term process. One has to be very patient, hard working, and in good shape to pursue good oversight. Those are things that sometimes are lost in these exercises.

The impact of good oversight, however, on an agency can be devastating. During the EPA controversy, again, the impact on the morale of the agency was devastating because one can't pursue the agency mission while you're looking over your shoulder at congressional subpoenas from four different committees.

The unfortunate outgrowth of it is, and I'm sure that's the case with the HUD investigation, that even well-meaning and diligent employees in the bureaucracy will find it hard to make objective and cool decisions in the teeth of a congressional oversight investigation. And it has a very deleterious effect on morale.

It also has an impact, indirectly usually, on decisionmaking because while the agency is under the intense light of congressional scrutiny, its decisionmakers and the decisionmaking processes are also opened. And it has a tendency to skew the decisionmaking that is made away from sometimes agency precedent and away from statutory criteria to the perceived evil that is being exposed in the oversight.

None of that is to say that Congress is either constitutionally required or should stay its hand. Many of these investigations yield real results in terms of reform of agency authority or reform of procedure, or in fact, the Inspector General Statute, as was pointed out, is itself an outgrowth of a congressional oversight exercise.

Those are very general comments in terms of the process, but I think they're probably all applicable to the current situation. And I would say that what has to be kept in mind as Congress does proceed is that it does have a lot of ways of impacting the process, other than by specific legislative solutions. It's very active in its examination, which often times produces results and sometimes very good results.

Senator **Graham**. Thank you, Mr. Brand.

Mr. Wegman.

STATEMENT OF RICHARD A. WEGMAN, ON BEHALF OF THE NATIONAL ACADEMY OF PUBLIC ADMINISTRATION, WASHINGTON, DC

Mr. **Wegman**. Thank you, Mr. Chairman.

My name is Richard Wegman. I'm here on behalf of the National Academy of Public Administration, which conducted a study of congressional oversight, focusing primarily on regulatory agencies, several years ago. I also have some experience with oversight, myself, since I served as Chief Counsel and Staff Director of the Senate Governmental Affairs Committee from 1975 to 1981.

Congress has frequently struggled with the difficult and daunting task of how to carry out its oversight responsibilities. Certainly, in recent years, there have been a rash of problems at a number of agencies. You've been focusing this morning on the problems that occurred at the Department of Housing and Urban Development. There are problems in Pentagon procurement programs, in the Food and Drug Administration's oversight of generic drugs, and of course, perhaps the problem of greatest magnitude has been the developments in the savings and loan industry, and the failure of both executive branch and congressional to properly oversee those programs. It's caused a lot of people to ask what can be done to prevent these kinds of problems from recurring.

In my judgment, there are generally three factors or some combination of these factors that need to be addressed. First, the question of leadership in the agencies themselves. Are we getting competent individuals to run these programs?

Second, what about congressional oversight? How extensive should it be? What is the appropriate balance between vigorous oversight, and crossing the line into the area of micro management, where agencies really have difficulty doing their job?

Finally, what about the role and function of the media, and what kind of role does the media play?

The National Academy of Public Administration has looked at the first two of those problems. On the oversight question, NAPA has found that oversight is most useful when congressional committees and subcommittees engage in thorough, systematic review of programs, and make an effort to seriously match performance against goals, costs against benefits, and implementation against congressional intent.

An excellent example of this occurred a number of years ago—and again, this is in our judgment—when the Subcommittee on Administrative Practices of the Senate Judiciary Committee conducted a thorough, in-depth review of airline regulation at the Civil Aeronautics Board. It's often cited as one of the exemplary instances of congressional oversight. As a result of the months and months of digging and hearings, Congress reviewed the entire program and decided to deregulate the nation's airlines, and ultimately eliminated the Civil Aeronautics Board. Now, today, there are questions about whether or not that was a good decision. I'm not addressing the merits of the decision on airline deregulation. But I do think it was an excellent example of how to conduct a thorough, systematic review of an agency program.

Unfortunately, this kind of oversight tends to be the exception, not the rule. As Stan Brand indicated a couple of minutes ago, that kind of oversight requires enormously long hours of dedication, huge staff resources, and usually there's very little political payoff. Media coverage is often scanty for that kind of oversight and——

Senator MACK. Like what we're experiencing here today, actually. [Laughter.]

Mr. WEGMAN. That may be.

Another problem with doing thorough congressional oversight is the daunting nature of the task compared to the resources that are available. When we're looking at the executive branch as a whole, we're dealing with $1.2 trillion worth of Federal programs. There are more than 5 million Federal employees, including the Postal Service and the Military. I believe your own committee has just 50 professional staff, and these must carry out legislative tasks in addition to their oversight tasks. And their oversight tasks include not only the HUD budget but also the other agencies under your committee's jurisdiction. And HUD alone has a budget of $23 billion and 14,000 employees. Thus, there is a tremendus imbalance between the oversight task and the resources available.

I see the red light is on. Let me just quickly mention four key elements that NAPA found are central to good congressional oversight.

First, it's essential that there be clear and explicit performance goals for executive branch programs. This would enable agencies to provide a better match between these goals and the resources available to carry them out. Clarity is extremely important; otherwise, it's very difficult for Congress to make a judgment about whether or not the agency is doing its job effectively.

Second, as one of the previous witnesses pointed out, it's very important that there be good two-way communication between the committees and the agencies they oversee, and both GAO and the Inspectors General need to be part of that process. If the agency and Congress can see eye-to-eye on what the mission and goals ought to be, the chances for effective oversight are greatly increased. On the other hand, if Congress and the agency are on a collision course, as in the example Stan Brand was mentioning a few moments ago involving EPA and the previous administration where quite clearly the administration wanted to do very different things with EPA than Congress wanted it to do, then a collision course is almost inevitable.

Third, NAPA believes that it's very important that there be better advance oversight planning and coordination by the committees so that the clash between jurisdictions can be avoided as much as possible. That doesn't mean it's going to be possible to eliminate that because, again, the committee jurisdictions and the lines between them are sometimes a bit fuzzy. But that coordination can certainly help.

Finally, when committees do complete their oversight work and issue reports, it would be very helpful if those reports were followed up. It's essential that there be some effort to make sure that the agencies are in fact fulfilling their mandate, and carrying out the recommendations that they've agreed to carry out.

Finding that proper balance between effective oversight and allowing the agency to do its job is difficult, but it's something NAPA believes has to be done if congressional oversight is going to be effective.

[The complete prepared statement of Richard A. Wegman follows:]

NAPA
National Academy of Public Administration
Chartered by Congress

STATEMENT OF

RICHARD A. WEGMAN
CHAIR, NAPA CONGRESSIONAL OVERSIGHT PANEL

BEFORE THE

HUD MOD/REHAB INVESTIGATION SUBCOMMITTEE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

ON CONGRESSIONAL OVERSIGHT

May 8, 1990

1120 G Street, N.W., Suite 540 Washington, D.C. 20005-3801 (202) 347-3190, FAX (202) 393-0993

Mr. Chairman and Members of the Subcommittee:

I am Richard A. Wegman, a partner with Garvey, Schubert, & Barer, and a Fellow of the National Academy of Public Administration (NAPA). I am pleased to be here to respond to your request for our views on congressional oversight. During 1987 and 1988, I served as chair of NAPA's Congressional Oversight Panel which produced a report in September 1988 titled, Congressional Oversight of Regulatory Agencies: The Need to Strike a Balance and Focus on Performance. A copy of the report has been made available to the Subcommittee. My testimony today is based on the views of the panel as expressed in that report and other relevant Academy studies, and not the Academy as an institution.

Almost since the beginning of the Republic, Congress has struggled with how to effectively carry out its oversight responsibilities. The recent rash of major federal program scandals, highlighted by the political favoritism and program abuse at the Department of Housing and Urban Development (HUD), have caused growing numbers of people to ask why the Nation's elaborate oversight apparatus--the array of congressional committees, the GAO and other staff arms of Congress, the inspectors general, regulatory agencies, and an army of investigative reporters--has not been more effective in identifying such problems and taking action before they reach a point of crisis.

Generally, there are three problems associated with these situations. The first is inadequate, inexperienced or insufficient program management by the responsible agency. The second is a failure of congressional oversight, the subject of today's hearing. The third is inattention or indifference on the part of the media to the seemingly routine problems of government. The National Academy has studied the first two of these three, and they will be the subject of my testimony.

THE CHALLENGES OF EFFECTIVE OVERSIGHT

According to many observers, Congress' approach to oversight is unsystematic and sporadic. Committees and members tend not to get involved until the problem is urgent and evident. Then the response seems aimed more at the television camera than correcting the underlying problems. Effective oversight is hard work. It takes time; the issues are often complex; the political pay-off is low; and media coverage is infrequent unless there is a human interest angle or scandal is rampant.

The task is also enormous compared to the resources available. Even with the growth in budget and staff over the past two decades, Congress still has relatively few people to explore every corner of a $1.2-trillion federal budget carried out by more the 5 million federal employees, including the Postal Service and the military. The staff director for Tom Lantos' House Government Operations subcommittee investigating HUD told a recent NAPA group that only one staff member oversaw the Department before the scandal broke. The Senate Banking Committee has a $2.6 million budget and a total of about 50 staff to carry out its considerable legislative tasks and oversee a HUD budget of nearly $23 billion administered by about 14,000 employees.

With such limited resources, Congress must rely on outside sources for insights on developing problems. Whistleblowers constitute one important source. Last year Congress strengthened existing protections for whistleblowers by enacting Public Law 101-12, the Whistleblower Protection Act of 1989. This new law mandated that federal employees, especially whistleblowers, not suffer adverse consequences as a result of "prohibited personnel practices," and established the Office of Special Counsel's primary role as protecting federal employees from such practices.

Former Senator William Proxmire, recently chairman of the Banking Committee and one of Congress' strongest practitioners of oversight, spoke frankly about the problem at a January 1989 Academy meeting. Commenting on the huge thrift industry losses, he said:

> I was on the committee for 31 years, and I was chairman during part of this disaster. I should have been a lot more aggressive, but we failed. The administration failed too; the regulators failed; Congress failed. . . . We should have realized that when we made drastic changes in the law which enabled the savings and loans to invest in just about anything they wanted, and we took the caps off the interest they had to pay, that there were going to be changes. We should have been following that up.

> I think [members] are much too timid, and I think they ought to be a lot tougher. Certainly there is a problem with multiple jurisdictions. . . We do need, however, some proliferation. I think the duplication we have between authorizing committees and appropriations subcommittees is probably healthy.
>
> [We] ought to see that members recognize they have a very vital responsibility to see that when they pass legislation, it is pursued conscientiously, and the public interest is protected. The only way you can do that is through oversight.

Beyond these challenges of oversight, our experience has been that there is almost no constituency in Congress or the public for "good management"--the people, the institutions and the processes of government that carry out the laws. Good people and effective management systems likely would have prevented the HUD scandal from happening in the first place.

NAPA CONGRESSIONAL OVERSIGHT PANEL RECOMMENDATIONS

The NAPA Congressional Oversight Panel addressed three basic questions: What constitutes effective oversight? How does Congress go about its oversight activities? What can Congress, the president, and administrative officials do to ensure that oversight is less adversarial, does not stymie administration, and accommodates the needs of both branches? Our fundamental conclusion was that Congress and the Executive Branch work best when the relationship is neither excessively antagonistic nor overly cozy. Congress needs to balance ad hoc oversight with independent, systematic, and long-term analysis of agencies, laws and programs.

I have attached to my statement a detailed list of the panel's recommendations, modified slightly to cover Congress' general oversight responsibilities. These are the key elements:

-- Establishing good performance goals and providing a better match between those goals and the resources available to carry them out.

- Better advance oversight planning and coordination by committees, leading to a formal oversight agenda at the beginning of each Congress.

- Committee funding tied to oversight agendas.

- More communication between committees, agencies they oversee, GAO and the inspectors general.

- More thorough, systematic and comprehensive program evaluations by the agencies.

- Improved reporting and follow-up on congressional oversight activities.

We realize there are practical problems, such as the division of Congress and the executive along party lines and constraints on resources, that may make it impossible to achieve the balance we seek and the systematic approach we advocate, but we are confident that some progress is possible.

There is a limit as to how much can be accomplished through oversight. Often the the problems taken up in oversight hearings represent basic policy differences between Congress and the executive. Our panel did not believe that political differences must be eliminated for oversight to work. In fact, a vigorous debate over the direction of public policy is both essential and desirable. It must be balanced, however, with the recognition of the need for a minimum level of cooperation and common ground so that government can function. Improving this cooperation is the subject of a current Academy study on Congress and the executive.

PREVENTING HUDS BY GETTING CAPABLE, QUALIFIED MANAGEMENT

Even with the best of congressional oversight practices, we believe fraud, political favoritism or mismanagement is still possible unless there is skilled, qualified leadership at the top of our large federal establishments. Getting the "right people for the right jobs" is still principally the president's responsibility, but Congress can help.

A few years ago the National Academy conducted the most comprehensive analysis ever undertaken of the presidential appointments system. A 1985 panel report, Leadership in Jeopardy, provided 23 recommendations for strengthening this system. Many of these recommendations were repeated in another Academy report on the president's executive responsibilities three years later. The 1985 report's first and foremost recommendation was that, "Substantive knowledge and administrative experience are not incompatible with political qualifications and should be primary criteria in the selection and confirmation of presidential appointees."

A few weeks ago at a NAPA panel meeting, a current HUD senior appointee characterized the department as a "dumping ground" for political aspirants that previous administrations could not place in other, presumably more essential government positions. He said--and we agree--that no department should be so staffed at the top.

More work is needed on strengthening the appointments system. For example, this administration got off to a slow start, in part, because it did not start actively recruiting large numbers of appointees until after election day. The Senate passed legislation in 1988 which would have provided transition funding in the summer before the election to begin the recruiting earlier by both candidates. This authorization, part of the Presidential Transition Act Amendments of 1988, was dropped in conference, however.

The Senate can help keep the pressure on for qualified departmental leadership during the informal clearance and confirmation process for individual appointees. The president needs to know that appointees' management qualifications matter.

Congress also needs to take another look at the number of appointees and their concentration in specific agencies. Our Leadership in Jeopardy report said, "The number of positions filled by political appointment has grown too large. The House Government

Operations and Senate Governmental Affairs Committees should conduct a government-wide assessment to identify and reconvert many of those positions where career executives have been replaced by political appointees." This study has never been undertaken, and the number of politically-filled positions continues to grow.

Each department needs to have at least one top position, reporting directly to the secretary, filled with either a highly qualified senior manager knowledgeable of the department or a senior career official. This person would be responsible for key internal operations--personnel, budget, financial management, procurement, information resources. In the past, career officials filling the assistant secretary for administration slot played much or all of this role. Now these jobs are generally filled by political appointees, and the duties often have been split among several individuals.

An Academy project team recently completed a study for HUD Secretary Kemp on improving financial management. Last fall, Congress enacted reform legislation recommended by the administration which, among other things, established a HUD chief financial officer. Our team recommended--and the secretary approved--establishing the chief financial officer and five program/administrative comptrollers as new career-reserved positions. The HUD CFO will provide leadership on financial management and also prepare the department's budget; therefore, he or she will have both substantive and administrative duties. This may serve as a precedent for other departments.

CHANGING CONGRESSIONAL BEHAVIOR

Encouraging steps are already being taken in Congress and elsewhere, following the recent scandals. For example, the Senate Governmental Affairs Committee staff is now reviewing, either at the full committee level and or cognizant subcommittee, every semiannual inspector general report and following up as needed. A few years ago, all of these reports were reviewed by a single individual on the full committee staff. Hearings are being held with the inspectors general to review current departmental problems. OMB has established a financial integrity unit to review annual agency reports of program vulnerability required by the Federal Managers Financial Integrity Act, and to track high-risk government programs. The GAO has conducted risk assessments and provided Congress in January 1990 its own list of 14 vulnerability areas; its audit coverage of these areas has been upgraded. Finally, newspaper and magazine reporters are beginning to pay more attention to internal operations issues, and more stories are appearing not only on the problems and scandals but also agencies capacities to fulfill their missions. Recent stories on the Food and Drug Administration and the Internal Revenue Service are but two examples.

As the recent NAPA study found, authorizing committees should be encouraged to periodically evaluate programs within their jurisdiction. Our panel recommended that, at the beginning of each session of Congress, the chairman and ranking minority member of each full committee, together with subcommittee chairman and ranking minority members, and key staff personnel, develop a formal oversight agenda for the upcoming Congress, and request the necessary funding to carry out these responsibilities. There should be an effort, over a period of years, to review all major programs and agencies within each authorizing committee's jurisdiction.

We also believe, however, that the Senate Governmental Affairs Committee and the House Government Operations Committee have key roles to fulfill. These committees have the advantage of distance -- and thus perhaps a bit more objectivity -- in reviewing executive branch programs and functions. In addition, since the purview of these committees extends to the entire executive branch, they have the opportunity to survey a wide variety of programs, and to compare what works and what doesn't in the implementation of congressional mandates. The recommendations of these committees should be especially helpful to the authorizing committees when programs come up for reauthorization, and to the appropriations committees as funding requests are considered annually.

Preventing more HUDs ultimately is a continuous process of improving program goals in law and testing agency performance against them, minimizing special-interest provisions in law and committee reports, and reducing opportunities for political deals afforded by discretionary funds in authorizing legislation. We believe a constituency for good management can be built by improving government performance. That means paying more attention to management issues before problems reach a crisis point and quality of the people who provide leadership in the federal government.

Mr. Chairman, this completes my statement. I would be pleased to answer any questions you or other members of the subcommittee may have.

ATTACHMENT

RECOMMENDATIONS OF NAPA CONGRESSIONAL OVERSIGHT PANEL MODIFIED TO MEET GENERAL OVERSIGHT REQUIREMENTS

Central to all of the recommendations made by the National Academy of Public Administration's congressional oversight panel was the recognition that oversight is more effective if there is bipartisan agreement of what oversight is to be performed and the results to be achieved, and if federal departments and agencies accept Congress as a partner in the policy-making process.

The following list of selected recommendations from the panel's report, Congressional Oversight of Regulatory Agencies: The Need to Strike a Balance and Focus on Performance(NAPA, September 1988), has been modified slightly to fit the broader context of general oversight requirements occasioned by the problems disclosed at the Department of Housing and Urban Development and Congress' response to them.

1. Congress and the executive should seek to develop a balance in their oversight relationships that avoids excessive antagonism, at the one extreme, or capture at the other. Oversight relationships must be sufficiently adversarial to ensure that programs are scrutinized and evaluated, but must be sufficiently accommodating to permit efficient and effective government.

2. Congress should set performance goals . . . that provide a better match between those goals and the resources likely to be available for implementation. Similarly, the executive branch should suggest to Congress ways of better matching goals and resources (report recommendation no. 4).

3. Congress should increase oversight which evaluates the appropriateness of . . . statutes and the effectiveness of administrative procedures to implement them. While, on occasion, ad hoc oversight may be the only feasible approach, Congress needs to concentrate on a systematic, long-tern analysis of laws and programs. Ad hoc oversight should be integrated with this work (report recommendation No. 5).

4. Each Congress should approve by resolution an oversight agenda of comprehensive, rotating examinations of . . . legislation and its implementation. Agencies should be required to submit . . . analyses of the appropriateness of relevant statutes, their capacity to carry out their mandates, and any recommendations for amendments (report recommendation no. 6).

5. Congress should revise its process for funding its committees' oversight operations so that a significant portion of resources is allocated in response to committee

proposals for systematic evaluation of specific statutes, agencies, and programs (report recommendation no. 8).

6. In each committee, the chair and subcommittee chairs, ranking minority members, and their top staffs should meet at the beginning of each session of Congress to establish a formal oversight agenda, including a schedule of programs to be reviewed, and the assignment of subcommittee and staff responsibilities (report recommendation no. 9).

7. Chairs and ranking minority members of committees and subcommittees that share jurisdiction over agencies should consult with each other and with the leadership of each house at the beginning of each session to coordinate respective agendas accordingly (report recommendation no. 10).

8. Congress should encourage coordination of and follow-up to oversight activities by requiring that: committees or subcommittees prepare a report for each oversight project; agencies be required to inform the committee of actions taken or planned on recommendations; and those reports and agency responses be circulated to all relevant House and Senate committees (report recommendation 12).

9. Committee and subcommittee chairs and ranking minority members should meet more regularly with GAO [and inspector general] officials to help establish the committee's oversight agenda and coordinate the activities of committee staff and the GAO [and inspectors general] (report recommendation no. 14).

9. Congress should ensure that agencies engage in more thorough, systematic, and comprehensive evaluations of the programs they administer by: earmarking funds for program evaluation; providing in authorizing statutes criteria by which to measure program effectiveness; and setting deadlines for submitting evaluation reports to committees (report recommendation no. 15).

10. Agencies themselves should ensure good cooperation and communication with the Congress and full compliance with enabling statutes. They should make suggestions for: areas of agency activity and statutes that would benefit from oversight proceedings; needed statutory improvements; and priorities for regulatory actions. Agencies should also seek budgets sufficient to achieve the tasks Congress has delegated to them (report recommendation no. 17).

Senator **Graham**. Thank you, Mr. Wegman.

Mr. Mann.

Mr. **Mann**. Mr. Chairman, Senator Mack, I'm delighted to be invited to testify before you today.

Last week, your staff brought together my colleague and I to look at the matter of congressional oversight in the context of HUD. We discovered that we agreed in our diagnosis and in our prescription, and consequently, we have collaborated on a piece of testimony which you have before you.

Mr. Rockman will begin with some initial remarks, and then I will very briefly summarize our specific recommendations.

TESTIMONY OF BERT A. ROCKMAN, SENIOR FELLOW, GOVERNMENTAL STUDIES PROGRAM, THE BROOKINGS INSTITUTION, WASHINGTON, DC

Mr. **Rockman**. Thank you, very much.

Very briefly, Mr. Chairman and Senator Mack, the first line of administrative control in any Federal program lies within the agency that administers it. If that agency fails to perform the proper internal audits, and if its top political executives subvert the mechanisms of administrative control, Congress is in no position to fill the breach. It neither can nor should manage or audit the programs from Capitol Hill. The task of Congress is to examine how well the programs are working and whether the systems and administrative controls are up to the task.

Congress has been criticized—and I think this morning as well—for failing to heed the warnings of the HUD Inspectors General. First, we should point out—I really do not need to point out to those of you on the other side of this table that there are many demands on your time, both on the attention of members and also on the attention of staff. During the Reagan years, both the Authorization and the Appropriations Committees dealing with HUD were distracted by a number of competing concerns, especially involving budgetary matters. Under these circumstances, both HUD warnings had little chance of getting the attention of an oversight investigation.

The second point that we want to make is that congressional oversight is most vigorous and effective when members see political advantage in it. This is a political body. Oversight is likely, therefore, to be motivated by the perception that executive abuse fundamentally has political overtones and is not a purely managerial matter. Scandal provides strong incentives for oversight inquiries because it provides opportunities for members to gain some political capital, and also a chance to embarrass political opponents. We observe simply that political motives provide a context for oversight inquiry. We would also observe that this is both reasonable and conducive to effective inquiry.

In short, members of the Congress have to be alerted to the existence of a problem when they have so many things vying for their attention. And they have to see a payoff in pursuing and remedying that problem when there are so many other activities that have to be attended to.

Broadly speaking, we might characterize two types of oversight activity that have to be attended to. Two political scientists, Matthew McCubbins and Thomas Schwartz, draw a distinction between fire alarm and police patrol types of oversight activity. Fire alarms are responses to clear signals of trouble. Police patrols, on the other hand, are a set of mechanisms to provide an ongoing inspection of potential problems.

The growth of staff capability, lessened opportunities especially in the 1980's for new legislative programs, and conditions of divided Government all work to promote a greater degree of inquiry into the operations of existing programs. Congressional oversight has come to be more effective and more frequent because the context has become more conducive to oversight activity.

However, the process cannot achieve an error-free system. The first line of defense against maladministration of programs is administrative control. Unique to our system, the legislative branch provides a second line of defense. That second line of defense has been bolstered by a certain amount of redundancy in the overlapping of committee and subcommittee responsibilities in both chambers of the Congress.

Both types of oversight activity are necessary, but the heavy demands on the time of members of Congress almost inevitably dictates that a lot of oversight will be of the fire alarm variety. That is to say, smoke is going to have to be seen before the fire.

Understandably, the question that this subcommittee would like to have answered is how to get early warnings of the types of abuses we see being revealed at HUD.

More specifically, what are the conditions that might lead Congress to be more sensitive to situations in which there will be serious breakdowns of administrative control within the executive branch.

Let me just point out, before turning it over to Mr. Mann, that there are two I think important conditions which Congress has to be especially sensitized to:

One is when Presidents hold either extremely deferential or extremely denigrative attitudes toward an agency and its missions. The former may have been the case in the Defense Department during the 1980's. And at other times, when it holds particularly neglectful attitudes toward an agency, these are conditions which probably should signal to Congress the need to pay sustained attention.

Let me at this point turn our discussion over to Mr. Mann.

TESTIMONY OF THOMAS E. MANN, DIRECTOR, GOVERNMENT STUDIES PROGRAM, THE BROOKINGS INSTITUTION, WASHINGTON, DC

Mr. **Mann**. Thank you. I am afraid we do not have a panacea for congressional oversight, but we do not see a tremendous crisis of oversight, either. Hindsight is always perfect. It is 20/20. It is also the case that there are self-correcting mechanisms that emerge after a crisis of this proportion and publicity, as seen in the testimony of my colleagues here. Adaptations in the oversight process have already occurred. Nonetheless, we have a couple of suggestions for your consideration.

Some are of the fire alarm variety—that is, how to make sure someone turns on those alarms sooner so we get earlier warning before too much damage is done.

First, we suggest the importance of supporting and adequately funding administrative control mechanisms. In times of budgetary stringency, the first items to go are administrative overhead. That is true of the agencies themselves and of decisions at OMB. It is also true of Congress. I think it is very important to look at programs within departments which are composed essentially of discretionary contract authority and third party payments. That is a signal that we ought to spend more on administrative control mechanisms rather than less.

Second, we urge strengthened congressional links to the Inspectors General offices. I listened to the testimony of Mr. Dempsey and Mr. Adams, and I do not have any doubt that they believe their signals to the Congress were crystal clear. However, for someone who is not an aficionado of these reports, I have to tell you they are long, vague, and boring, and they are not likely to get the attention of members of the Congress or of congressional staff. IG's are in inherently ambiguous positions in the agencies. Under these circumstances, what is needed is more informal contacts between congressional staffers and IG staffs. Frankly, the formal reports will always be too qualified and ambiguous to signal Congress.

Third, I think Congress should continue to do what it has been doing in recent years to encourage whistle-blowing. There is a fine line between encouraging appropriate alarms from agencies and sounding false alarms. Nonetheless, I think that the Congress has taken important steps recently in the 1989 Act. Both the Congress and the President should also seek informal ways of encouraging whistle-blowing.

What about the other side? If fire alarms are designed to send clear signals of administrative problems to the Congress, how can Congress in turn send clearer signals to the agencies in advance? How can they engage in systematic police patrolling in the agencies?

We suggest one thing to do is to take another long, hard look at the whole confirmation process. The HUD disaster is a disaster in large part of its political appointees. I think Congress vacillates oftentimes between absolute deference to the President in terms of appointees, and on the other hand those occasional highly charged ideological battles. Well, in between there are a lot of important things to take a look at.

We suggest the minor flaws in the backgrounds of nominees often get too much attention, and their suitability for particular jobs gets way too little. We also think it is time to take another look at the layers of political appointees in the agencies and see if that balance is out of kilter.

Second, we think you ought to take a fresh look at the House experience of setting up an oversight subcommittee on each of the committees. There are benefits to some degree of jurisdictional overlap and competition as well as costs, as Mr. Brand has pointed out. At least in the House, it has ensured a minimal level of oversight by giving responsibility to members and staff who are not consumed with trying to protect those programs through the authorization process.

Third, we think there should be more systematic evaluation of programs. During the 1980's, there was a sharp reduction in the analytic capacity of Government. I think this is a large problem, and one of the things I worry about, quite frankly, is that in all the concern for scandal we are going to take what modest resources we have for review and evaluation and put it into rooting out corruption, leaving too few resources for long-term, systematic evaluation. Are these programs getting the job done? If not, why not?

Finally, we think it is important—and we say this with the full appreciation of the nature of this legislative body—to diminish congressional appetites for the pork barrel. We have been critical of the executive because the mess that occurred at HUD is largely a failure of executive control, but Congress has its own complicity: excessive pressures on agency officials from members of Congress to steer awards to favor constituents sends a signal that political manipulation of programs is acceptable behavior.

It is a fine line. You are supposed to deliver benefits for your States. At the same time, if a program is nothing but an opportunity to carve up the Federal resources for beneficiaries distributed geographically, then it sends a clear signal that that kind of abuses uncovered at HUD are OK.

To conclude, we think that you ought to recognize that Congress by and large has performed its oversight pretty well. Congress is not the first but the second line of defense. The fire alarm worked. The power to embarrass is an enormous resource of Congress, and the Lantos subcommittee has sent a powerful message that will last for awhile.

On the other hand, it is important to assure the right balance between fire alarms and police patrols. I commend you for trying to make sure Congress uses both resources.

Thank you.

[The complete prepared statement of Thomas E. Mann and Bert A. Rockman follows:]

Testimony of

Thomas E. Mann
Director of Governmental Studies
The Brookings Institution

and

Bert A. Rockman
Senior Fellow
The Brookings Institution

Before the

HUD Investigation Subcommittee
Committee on Banking, Housing and Urban Affairs

United States Senate

538 Dirksen Senate Office Building
Washington, D.C.
May 8, 1990

We are pleased to appear before this subcommittee to discuss congressional oversight of the U.S. Department of Housing and Urban Development (HUD). The views expressed in this testimony are our own and should not be ascribed to other staff members, officers or trustees of the Brookings Institution.

We commend your efforts to explore whether shortcomings in the processes of congressional oversight may have contributed to the HUD scandal--by failing to anticipate the special circumstances that might well foster a breakdown of administrative control or to uncover and curb the influence-peddling abuses at an earlier stage. It is possible and helpful to use the HUD experience to evaluate how well Congress is performing its oversight responsibility and how its performance might be improved in the future.

We have no doubt that the primary responsibility for the abuses at HUD lies with the executive branch. The politicization of awards, the fraud by third party contractors, and the theft at the grass roots were fostered by the cynicism and disdain for the mission of the department by its political appointees. The first line of administrative control in any federal program lies within the agency that administers it. If that agency fails to perform the proper internal audits and if its top political executives subvert the mechanisms of administrative control, Congress is in no position to fill the breach. It neither can nor should manage or audit the programs from Capitol Hill. The task of Congress is to examine how well the programs are working and whether the systems of administrative control are up to the task.

Congress has been criticized for failing to heed the warnings of the HUD Inspector General and for leaving to a House oversight subcommittee, rather than the House and Senate committees directly responsible for HUD, the job of rooting out the truth. These criticisms illuminate two central features of congressional oversight. First, there are many demands for the time and attention of members of Congress and their staffs. During the Reagan years, the HUD authorization and appropriations committees were distracted by many competing concerns, not the least of which was the administration's effort to slash the HUD budget. Under these circumstances, the qualified warnings buried in the Inspector General reports had little chance of getting the attention of the oversight committees.

Second, congressional oversight is most vigorous and effective when members see political advantage in it. Since our checks and balances system of government is built on the premise that different governing institutions ought properly to reflect different sets of interests, it is not surprising that the smell of scandal in the executive will be picked up more readily by the Congress when it and the executive are composed of different political majorities. However, once executive abuses become clearly signaled, there is good reason for members of both parties to be more involved in efforts to investigate and correct them. There is no doubt though that Congress is a political institution, not a managerial one. Oversight is likely, therefore, to be motivated by the perception that executive abuse fundamentally is a political rather than a purely mangerial matter. Scandal provides strong incentives for oversight inquiries because it provides opportunities for members to gain political capital and embarrass political opponents. We would observe simply that political motives provide the context for oversight inquiry, and that this is both reasonable and conducive to effective inquiry.

In short, members of the Congress have to be alerted to the existence of a problem when they have so many things vying for their attention. And they have to see a payoff in the pursuit of remedying that problem when there are so many other activities that have to be attended to.

Broadly speaking, we might characterize two types of oversight activity. Two political scientists, Matthew McCubbins and Thomas Schwartz, draw a distinction between **fire alarm** and **police patrol** types of oversight activity. Fire alarms are responses to clear signals of trouble. Police patrols, on the other hand, are widespread routine searches for information. A recent book published by The Brookings Institution entitled **Keeping A Watchful Eye,** authored by Joel D. Aberbach, presently professor of political science at UCLA, documents the growth of both types of congressional oversight activity. The growth of staff capability, lessened opportunities for legislating new programs, and conditions of divided government all work to promote a greater degree of inquiry into the operations of existing programs. The message of his book is that congressional oversight has come to be more effective and more frequent because the context has become more conducive to oversight activity. Our Brookings colleague Christopher H. Foreman, Jr. reached a similar conclusion about the success of congressional oversight in his book, **Signals From the Hill**. In sum, as we earlier noted, the abuses at HUD are not the result of a breakdown in congressional oversight. To the contrary, the oversight process as a whole has been an effective one. But the process cannot achieve an error-free system. The first line of defense against maladministration of programs is administrative control. Unique to our system, the legislative branch provides a second line of defense. This second line of defense, moreover, has been bolstered by a certain amount of redundancy in the overlapping of committee and subcommittee responsibilities in both chambers of the Congress.

Both types of oversight activity, fire alarms and police patrols, are necessary. The heavy demands on the time of members of Congress almost inevitably dictate that a lot of oversight will be of the fire alarm variety. That is inherently a key congressional role and is a part of the second line of defense we have talked about. It is, however, a reactive mode of oversight. And it is especially well-suited to uncovering scandalous abuses of executive authority such as those being discovered at HUD.

Understandably, what this subcommittee would like to have answered is how can we get early warnings of the types of abuses we see being revealed at HUD? And also, how can Congress be more proactive in overseeing federal agencies without interfering unduly with the managerial responsibilities that inhere in the agencies?

More specifically, what are the conditions that might lead Congress to be more sensitive to situations in which there will be serious breakdowns of administrative control within the executive branch?

When presidents hold either extremely deferential or extremely denigrative attitudes toward an agency and its missions, it is probably wise for Congress to be on special alert. The case of extreme deference may engender little concern within an agency for effectively managing resources precisely because resources are both abundant and oftentimes untargeted. Clearly, this sort of problem arose in the Department of Defense during the Reagan administration. The case of extreme denigration, as appears to be the situation with HUD during the years of the Reagan administration, also poses the danger of abuse. Indeed, it was precisely the contrast between the Reagan administration's program cuts at HUD and the abuses of discretionary authority by the management of the agency that has made the problems there so salient. The attitude "we don't care" does not have to be given overtly for it to be picked up in an agency. These two conditions of extreme deference and extreme denigration both have considerable potential to lead to a loss of managerial control. Under these circumstances, it would be especially advisable for Congress to be on the lookout.

As we look at ways to improve congressional oversight and avoid the types of problems posed by the events at HUD, our suggestions fall into two broad categories: (1) improving the clarity of signals coming from the agencies, and (2) sending clearer signals from the Congress to the agencies.

What are the ways in which signals from the agencies to Congress might be made clearer?

1. **Support and adequately fund administrative control mechanisms.** Agencies tend to treat internal control mechanisms as overhead costs not central to their missions. In times of budgetary stringency these costs become less of a priority to the agencies and are among the first items singled out for cuts by Congress. They are important, however, and more resources devoted to internal policing might have brought the management

abuses at HUD to attention earlier. In this regard, the staffs of the IGs may well need enlargement especially when departmental budgets are significantly composed of discretionary contract authority and third party payments. There is always a large potential here for abuses and a correspondingly special need to keep "a watchful eye."

2. **Strengthen congressional links to the IG offices.** The role and authority of the inspector general is inherently ambiguous. The office of the IG lies inside a department with reporting obligations inside and outside to the Congress. When it is clear within an agency and in the executive more broadly that uncovering abuses is not encouraged, the IG is placed in an exceedingly difficult position. Under these circumstances, it is not surprising that the IG report has been criticized for failing to sharply and clearly state the problems that were going on at HUD. It is not that the issues were absent in the reports, it is that they failed to stand out. One had to be looking hard to find them; that is not normally how the unsuspecting are alerted to matters they need to be alerted to. The structural position of the IG is a difficult one when there is little support from the political arm of the agency. It is made more difficult as Mr. Gilliam recently pointed out in testifying before the Lantos subcommittee when there are other politically sensitive issues that might inhibit the IG from probing further or from issuing less ambiguous conclusions from existing probes.

While there is relatively little that can be done from a strict legislative standpoint, it would be helpful for Congress to encourage as much informal contact between relevant committee/subcommittee staffs and IG staffs above and beyond the formal exercises that now take place through the IG reports. The staffs are an important part of congressional capability. The more traffic between IG and congressional staffs, the more likely it is that important "intelligence" will not fall through the cracks.

3. **Encourage whistle blowing.** We recognize that there is a fine line between encouraging appropriate alarms from within the agencies and sounding false alarms. Efforts to encourage more of the former need to be balanced with concerns for encouraging too much of the latter. At the present time, we believe that the balance still inyhibits engendering signals from personnel in the agencies about real problems until that knowledge is already public. The Congress, and especially the Senate, from time to time has expressed concern for increasing protection available to whistle blowers, most recently in the 1989 legislation. It is helpful to keep these concerns alive.

If one side of the problem of generating a more proactive congressional stance toward potential abuse in the agencies of the type afflicting HUD is to get clearer signals from the agencies, the other side is that Congress needs to send clearer signals to the agencies. What are the mechanisms for Congress to do that?

1. **The Senate should examine nominees to appointive posts in the executive more carefully.** As with whistle blowing, there is also a careful balance that needs to be achieved here. There is a fear that examination of nominees too often rests upon episodes in one's past than upon the nominee's competence for the job to which the person is being nominated. Understandably, there also is a concern that the president retain maximum discretion in appointing the members of his administration. Too often, though

increasingly less often, this has led the Senate to confirm individuals with little competence for their jobs. The governing of the agencies is a jointly shared function of the executive and the Congress. The executive needs to manage and the Congress needs to oversee it. The best assurance that Congress can have in this process is that the nominees who are confirmed for their positions be qualified to hold them. This, of course, never can be an error-free process. But the rights of the Senate on this issue are completely clear and the Senate should insist that only the qualified hold positions of responsibility to which it is being asked for its advice and consent. There was no doubt that HUD was a dumping ground for political foot soldiers, mainly because the Reagan administration fundamentally did not accept its mission.

Presidents retain the right of nomination, and they can continue to send up ill-equipped nominees until the Senate tires of the process. Yet, it is important for the Senate to be focussed on the question of "how qualified is this person for the job" rather than whether there is a moment of minor embarrassment in a nominee's past. The first question is a perfectly legitimate -- indeed, it is the legitimate -- basis for senatorial confirmation; yet, presidents, whatever their party, have been more successful in conveying the belief that they have a virtually unbounded right to expect confirmation of executive nominees. We might add here that it would be worth congressional attention to begin inquirying as to whether the layers of political appointees improve the performance of the agencies or create a large potential for serious problems. One of the virtues of limiting the numbers of political appointees and enlarging the responsibilities of senior career officials is that the competencies of the career executives are much less open to question. We need both, appointees and career officials, but a better balance between them than we presently are getting.

2. **Set up oversight subcommittees to ensure a minimum level of police patrolling in the Senate.** This recommendation has the decided virtue of ensuring that the Senate has a police patrol available both to discourage inappropriate behavior in the executive andto detect early signs of trouble. The oversight subcommittees on the whole have worked well in the House and allow inquiries to be focussed and separated from the committees and subcommittees with legislative and appropriating responsibilities. We do recognize, of course, that the Senate is a different body than the House; its members are stretched across far more numerous units and jurisdictions than are House members. Will members of the Senate be able to devote attention to the oversight committees as members of the House have? We cannot be sure as to the answers. We do believe, however, that staff members assigned to oversight subcommittees are in a better position to alert their principals (the members) to developments that need to be looked at earlier than is now the case.

3. **More attention should be paid to the systematic evaluation of programs.** In the long run, we need to know whether the programs presently being funded work. We also need to know whether they might work better if they were restructured. During the 1980s there was a reduction in analytic capability in spite of the fact that budgetary stringencies might have been expected to maximize the use of analysis to see where scarce dollars could do the most good. Two factors seem to have diminished the importance of analysis in government. First, the budget cuts themselves, as we noted, tended to most

affect the overhead functions of the agencies, including their evaluative and data-collecting arms. Second, the strong views of the Reagan administration on certain matters of social and regulatory policy seem to have virtually precluded any interest in analysis as a basis for decisionmaking since the answers already were apparent. Beyond the question of the present problems at HUD are larger ones about the forms the programs in question should take. Are these programs the best means to fulfill the designated mission? Would that mission be better performed under different and perhaps less inherently corruptible structures such as vouchers? We do not pretend to know the answers to those questions, nor are they ones presently within the subcommittee's range of inquiry. But asking such questions will be pertinent to the authorizing committee at a later point. And asking such questions necessarily leads to the underlying issue with which we are all concerned, namely, "are we presently getting the job done?" If not, why not?

4. **Diminish congressional appetites for the porkbarrel.** We have been critical of the executive because the mess that occurred at HUD is a failure of executive control. That does not mean, however, that there has not been some indirect complicity on the part of individual members of the Congress. Excessive pressures on agency officials from members of Congress to steer awards to favored constituents sends a signal that the political manipulation of programs is acceptable behavior. We recognize that a part of the job description of members of Congress is to try to gain allocative benefits for their districts and states. There is nothing inappropriate in doing so. Moreover, members will be held to account if they fail to gain their share of federal funds or fail to accommodate their constituents. Nevertheless, there is a fine line between constituency service and inappropriate interference in

agency decision-making. If pressures force congressional responses in the direction of carving up program benefits merely to favor private parties who are not central to the program mission, then serious consideration should be given to restructuring the programs in ways that minimize that temptation. Direct income transfer programs (such as vouchers) simply have less potential for this sort of manipulation.

To conclude, while we emphasize remedies for the larger problems of process this subcommittee is seeking to address, we want to return to the message we set forth at the beginning of our testimony. That message fundamentally is that on the whole Congress has performed its job of oversight well in this case. Given the many tasks required by the institution, the limited time available to members and staffs to sort through the immense volume of messages they receive, the fact is that the second line of defense worked. Despite the criticisms that are often made about the proliferation of congressional structures and staffs, the fact is that these give Congress more capacity to "keep a watchful eye." In our view, the public is well served by Congress having this capacity.

The fire alarm here worked. The Lantos subcommittee in the House performed effectively and with apparent comity across party lines. One of the weapons that Congress can wield in scandals such as that afflicting HUD is the power to embarrass those who have breached their public responsibilities. That sends a powerful message at least for a time.

For the longer run, one of our primary messages is in the form of what Congress probably should not do -- which is that it should not overreact to the HUD problem. It should not try to manage programs from the Hill, and it should not try to remove necessary managerial discretion so long as Congress prefers to leave existing program structures intact. We have expressed some of our thoughts on this but the program structures themselves lie outside of our own expertise.

The problem for Congress in order to improve its capacity to monitor the effective administration of the laws it passes is to ensure an adequate mixture of fire alarms and police patrols. In this, it needs to get clearer signals from the agencies themselves. Mostly, those signals will be of the fire alarm variety. Above all, though, Congress needs to send clearer signals to the agencies. These will be mostly of the police patrol variety. The police patrols are designed to monitor the administration of programs without excessive interference in the management of the agencies.

As we stated at the outset, this subcommittee is to be commended for its efforts to explore ways in which the oversight process might be improved. While we believe that the process basically works well, we have explored some possible means for making this process work better. We thank the subcommittee for the opportunity to discuss those with you today.

Senator **Graham**. Thank you, very much.

Our situation is as follows. A vote started 5 minutes ago, which is the first of three back-to-back votes. So once we leave, we will not be back for 30 or 40 minutes. What Senator Mack and I have agreed is that we will ask a preliminary question, then we will ask our staff to take our seats and pursue further questions, at the conclusion of which this hearing will be adjourned.

I apologize that we are not going to be able to spend more time in what would be a very helpful dialogue, but that is the nature of this business. We will limit ourselves to one question apiece. Is that OK?

My question is that I am very interested that several of you have talked about the fact that unless you link the review of management with a review of program goals and objectives, that you have set upon a path that is likely to end in frustration and lack of success. I am interested in (a) the issue of how we can achieve a greater clarity in terms of what those programs goals are; and (b) to be able to monitor the attainment of those goals as a thoughtful policeman rather than as a fireman, called only when the shortfall between goals and performance is so great as to be defined as scandalous.

Mr. Fogel, you made a very eloquent statement on that. Maybe I can ask you that question. Then after we leave, if any of the others would like to supplement.

Mr. **Fogel**. I think it goes back to something that both Mr. Wegman and I said in our statements. It would help if congressional committees could press some on the agencies to develop performance measures and output measures of what the agencies think are good measures of whether they are accomplishing program objectives.

You try to come into agreement on that, and obviously there is going to be some give-and-take, and there is some political risk in saying that you want to be held accountable. But that gives the Congress a basis for then going in and tracking and saying how well things are happening, what type of problems there may be, and if there are problems it gives you a basis for focusing the oversight.

Unfortunately, most agencies do not want to develop those types of performance measures because it is easier not to be held accountable if you do not have them.

Senator **Mack**. I guess just quickly, Mr. Mann, you told me that there is not a crisis in oversight, and I would not suggest that there is, but I think one of the things that does kind of stand out in my mind—even taking into consideration that there were political motivations, if you will, at some point during the 1980 to 1988 cycle—that frankly the smoke signals that were sent really were not received with respect to the IG report.

I just would be interested in a comment as to how we could focus in better on the smoke signals. I see I touched everybody on that.

Mr. **Wegman**. Could I just very quickly comment on that? I was struck by something that one member on the previous panel said, which was that they had been sending these semiannual reports to the Hill on problems at HUD and they never received a single phone call from anybody on the Hill. I guess I would have been tempted to ask him why they never picked up the telephone and called people on the Hill themselves.

I do not see why people in the agencies, particularly IG's but also other individuals, cannot be more proactive.

Senator MACK. I think that is what I was leading to. I was not clear enough and did not follow that up.

Mr. BRAND. I think Dick knows the answer to that question. The IG likes it when Congress is not picking up the phone and bothering them, because quite frankly he thinks his main function is to do his job and be left alone by Congress. That is their part of the "see no evil, hear no evil" part of the equation.

That is right. It would be easy enough to pick up the phone and say, by the way, this is a real hot one. You ought to know this. That is as much their obligation as it is for you to read it and see the early warning signs.

Mr. MANN. The reality is that, as you know better than we do, there is a tremendous amount of business demanding your attention. Unless someone signals you in a clear way, you are not going to be able to see it. It all looks so obvious now. Those reporters the former IG referred to that read the 21 reports did so after all the publicity came out. At that point it was easy to detect the warnings.

Senator MACK. We have a clear signal that we have to respond to now.

Senator GRAHAM. I apologize that conflict is now upon us. Thank you very much for your participation.

I would like to call on Mr. Leary and his colleagues to pursue the questions. Again, any supplementation of statements that you made, the record will be open for 30 days and any statements you would like to submit at this time will be incorporated fully in the record.

Thank you, very much.

Mr. WATT. Senator Graham asked that first of all we introduce ourselves. You did not anticipate this, and neither did we. My name is James Watt—not related to "the" James Watt, obviously. I am an attorney in West Palm Beach, FL, and serve as General Counsel to the Subcommittee.

Mr. LEARY. My name is Bill Leary. I am Staff Director to the Subcommittee.

Jim is correct. As luck would have it, in briefing the Senators we had some areas about which we wanted them to ask you. One of the questions I would really like to follow up on, which we were just dealing with, Mr. Fogel, is a question that Senator Graham has asked a number of panels, and I will relate the story that he normally relates.

When he was Governor of the State of Florida, he had his staff develop a number of indicators of effectiveness for various agencies, whether it was the Department of Transportation—how many road miles they developed, that sort of thing—so that his staff could know whether the agency was effectively carrying out its mission. And if a review of those indicators indicated that the agency was falling way short of the acceptable range, he could then inquire as to what the problems were that were occurring at that agency.

He is interested in knowing if such a list of indicators—a thermometer, if you will—that Congress could stick into HUD and test and see how they are doing in terms of the effectiveness of managing and monitoring programs, if such a list could be developed for HUD in particular, or for agencies in general.

It seems that this is similar to what you were suggesting about program goals. I was wondering if you believe that such a list could be developed for HUD and, following up on that, if you might provide the subcommittee, after giving it some thought, with what you think those indicators ought to be.

Mr. FOGEL. I think a list can be developed. I think it is first of all incumbent upon the executive agencies to try to develop those indicators. The experience with the management reviews we have done on agencies is that it is very difficult to get them to do that. Let me show you one example at the Social Security Adminstration.

We did a management review there a couple of years ago and said we thought it was key for them to try to develop better performance measures to see whether they were serving the public well, and also to try to develop better productivity measures. There has been extensive resistance to developing those measures within the bureaucracy of SSA.

One reason is a lot of people do not want to develop them because then they are going to be held accountable for the results. It involves developing productivity measures in some units vis-a-vis other units. They do not want the comparisons to take place. So it is very difficult to develop those. And if they are going to be used, they have got to be developed first by the agencies.

We would be glad to discuss this with you and try to work through, in the HUD context, how you could do it. But there has not been much success so far in getting agencies to do that.

Mr. LEARY. Any other comments?

Mr. ROCKMAN. I would just like to make a general comment. There was of course experience with management by objectives in the federal agencies in the mid-1970's or so, and I think the experience with that reveals that indeed with respect to certain programs those procedures can work fairly well. If the roles are clear, and if the indicators are relatively well agreed on, then there seems to be no problem in measuring performance.

The problem is when the goals are not so clearly agreed on, the indicators are not so clearly agreed on, and in some cases when there seem to be almost no indicators at all. The process looks like bean-counting from within the agencies. I think that is a significant part of the resistance. Within the agencies, people will want to know what is it that Congress defines as the indicators for how well a program is working.

Mr. FOGEL. Quite frankly, sometimes the Congress does not want to really clarify what the indicators are, either. It is easier to keep it somewhat confused. That creates additional problems for the agency.

Mr. LEARY. One of the issues that we have been examining is low income tax credits. Among the questions that one might want to know is, how effectively those tax credits are being used to ultimately provide either reduced rent to tenants, or in some way an indication of how much housing is being built.

We have been somewhat frustrated in finding out that a lot of the data that one might expect to be collected by an agency in order to determine the effectiveness of the programs is just simply not collected. Do you believe that the Congress should, with great specificity, perhaps impose data collection requirements to help Congress and the agency judge the effectiveness of its programs?

Mr. **Mann**. My own worry is that it takes on a life of its own and quickly gets disconnected from the original objective, which is to discover whether a particular program approach works rather than getting into details of data collection.

I would take the opportunity to try to mandate long-term, systematic evaluation of programs. Tony Downs testified before your committee some weeks ago. He made this point: If you look across the range of programs, the most useful review activities have been large-scale evaluations, with experimental designs. Many lessons come from those evaluations that are relevant to such important questions as vouchers in housing. So if by mandating data collection you mean insisting on broad-scale, systematic evaluation of the program, I say, yes. If you are getting into the matter of how they arrange the beans on the shelf, then I say, no.

Mr. **Fogel**. One way to approach it is to periodically call the agency officials up and ask them how well they think they are doing in that context. I do not want to downplay the salutary effect it can have of having the Secretary or another high-ranking person come up here several times and tell you, I am sorry, I do not have the answer to that. That does not sit too well. So sometimes maybe you do not have to specify the specific data elements you want to have collected, but you can certainly come up and ask them why they do not have it, and why they do not know what is going on in your programs. That is part of the persistence of following through.

Mr. **Watt**. I believe it was Mr. Wegman, although I may be wrong, that mentioned about the proposed chief financial office.

Mr. **Wegman**. Yes, it was in my statement. I did not touch on that orally.

Mr. **Watt**. I know that Senator Mack in the past when this concept has been discussed at one of our hearings has made the observation that already it seems to him that there are duplications and overlapping. You know, you have OMB doing certain things; you have the IG's doing things; you have the GAO doing things. My question I guess would be to all of you:

Do you see any duplication in what we have now? Would you see additional duplication if a new entity such as the chief financial officer was implemented?

And as sort of a corollary to that question about duplication, would you see any advantages to consolidating some of these different functions that are now in OMB, the IG, and the GAO?

Mr. **Brand**. I would just say that this may be over-simplistic, but if it is not done by Congress it is not oversight. It is something else. It is a bureaucracy that is not accountable—it is accountable to Congress, but not in the direct and immediate way that it is with Congress itself when one of its own committees does it.

I think you can set up chief financial officers, OMB's, IG's, watchdogs, and that cannot and never was intended to take the place of vigilant, strenuous committee oversight. I would opt more for a system that is more active on the congressional end rather than setting up yet another agency that will be subject to other pulls. It will be subject to all kinds of pressures and legal restrictions with the Executive Branch that will inhibit its mission.

Mr. **Watt**. If I could follow up on his comment before the others answer, again my reference goes back to legislative days in local government where you had internal auditors. As I understood it, their responsibility was to tell the head of that agency when something was wrong so that he or she could correct it before the rest of the world knew about it, and that was the whole purpose of an internal audit.

Would that be the equivalent on the Federal level of the Inspector General's office? I mean, are they sort of what we back in the State and local government might think of as internal auditors? And conversely, would the GAO be like what a lot of States have—Florida being one—that has an Auditor General, which is appointed by a joint committee of the House and Senate, or the legislature, and it reports directly to them and has the authority to go into any executive department and audit performance audits, et cetera. Would the GAO be the equivalent?

Mr. **Brand**. GAO is statutorily an arm of Congress. There is some doubt about how directly it can be linked to Congress after the Bowsher decision on Gramm-Rudman implementation, but, yes, that would be the analogy. GAO is the Congress' audit watchdog reporting to the Congress and accountable to it. I guess the Inspectors General are the on-site people.

Mr. **Watt**. Sort of like internal auditors. I think you have made a good point, that internal auditors are not legislative animals. I am sorry, maybe others wanted to answer my first question about duplication, overlapping, and consolidation.

Mr. **Wegman**. Actually, let me touch on that a little bit on the congressional level. There is a lot of potential overlap and duplication up here in the way agencies are overseen. On the front line, of course, are the authorizing committees, that put the programs together and periodically must make judgments about how well they are functioning.

As previous witnesses have pointed out, though, sometimes individuals on authorizing committees may get a little bit too close to the programs they are overseeing. On occasion their constituents may benefit directly from those programs, and therefore members may lose a bit of their objectivity. Appropriations Committees take a look at these programs once a year, but they are not conducting a bottom-up kind of evaluation. These committees are simply looking at the incremental funding that is requested.

Finally, you have the Governmental Affairs Committee in the Senate and the Government Operations Committee in the House with system-wide responsibility for how programs are operating, and they can take a look at any agency or department at any time. There is a lot of overlapping and duplication that system, but I think it is a very healthy system. I would not want to see it any other way.

Even with all of that overlap and duplication, Congress cannot do its oversight responsibility effectively without the assistance of people on the inside that know first-hand how these programs are operating. They have to rely to some extent on reports coming up to them not only from the IG's but also from individual whistle-blowers within the agencies who may see something going on that is amiss. That is why I believe the whistle-blower protection statute that Congress enacted last year is so important, because individuals have to feel that if they do that, their job is going to be protected.

The whistle-blower protections that Congress added last year were very useful, and that is something that Congress really has to keep an eye on to make sure that the people who do see waste, fraud, or abuse in agencies are willing to step forward. It takes a great deal of courage to do that. It is not an easy thing to do, because you are going to be vilified within the agency once you do it. And once the media attention goes away, who is going to look after the individuals who come forward?

It is important that Congress encourage that sort of thing and provide as many protections as possible.

Mr. FOGEL. I know you have already discussed in previous hearings the need for chief financial officers, but I do not think they are going to be duplicative. One of the problems we have seen over the years in agencies—and HUD is a classic example of this—is the lack of good program and financial information about what is happening in the programs.

One of the reasons we have this in a lot of agencies is that the function has not been focused properly at a high enough level, and there has not been a senior official that is really accountable for getting this information put together in a way that the top decisionmakers can help them make better decisions. So the whole idea behind this legislation is to bring a better focus to that so that we can get better program management.

Mr. ROCKMAN. If I may address the question for just a moment, I would like to agree with the comment that fundamentally it is Congress that performs oversight. The administrative arms perform what I would call supervision, active supervision, or supposedly active supervision of the administration.

From the standpoint of the oversight functioning, it is inevitably the case that the more redundancy there is, the more likely some signals are going to be heard somewhere and acted upon. The question becomes from the standpoint of this body in dealing with its economy of time and staff whose resources are not infinite, obviously, the question then becomes whether the costs of essentially all of the overhead investigation units would be greater than the cost of potential maladministration. But that is very hard to answer.

On the whole, I would support more redundancy rather than less. I think in fact Mr. Kaiser pointed out in his comments, quoting James Madison, that fundamentally our system is built on the premise of oversight.

Mr. WATT. My last question is that some people recently have raised the issue that inspectors general lose some of their independence when their prior position was in some type of administrative capacity within that agency. The other side of the coin is that—the defense of that is, well, I know the agency inside and out and therefore, given this new independence that I have, I will be a super IG.

What are your views on that? Should there be a prohibition on appointing somebody who is in essence going to be looking at programs that he might have administered before becoming an IG?

Mr. **Brand**. Sometimes I think, as a lawyer, you want someone who purports not to know anything about the agency but who knows how to investigate and how to uncover problems that exist. Sometimes the relationships and knowledge that are built can inhibit vigorous enforcement. If you want an ambassador, then those relationships are important. If you want someone who is going to root out fraud and abuse, then those may be inhibiting factors.

Mr. **Leary**. I wanted to touch on some questions on the confirmation process, but first, before I get to that, Mr. Wegman in particular, with your experience at the Government Affairs Committee, one of the questions of course that always comes up in congressional oversight is the overlapping nature of committees and who ought to be doing what type of oversight.

Certainly the Banking Committee, being the authorizing committee, one expects the members and the staff to be familiar with the programs; whereas, your committee perhaps is more expert on broader issues that cut across agency lines. How should that work? Are there problems with that that make congressional oversight difficult? Are there improvements that could be made in coordination perhaps with the committees?

Mr. **Wegman**. The answer is that of course there are problems—this type of problem is inherent given the overlap and duplication that exists in the system. There is no question that when the Governmental Affairs Committee decides to look into problems at a particular agency, as it occasionally does, as opposed to the generic, across-the-board type of question—is the Administrative Procedures Act functioning well, for example—other committees will resist. I cannot recall a single instance when we decided to look at a particular agency or program during the years I was there that we did not get a call from the authorizing committee asking somewhat nervously, well, what is it exactly you are planning to look at? And what kinds of hearings are you going to have? And could we be involved? And sometimes the other committees actually wanted to sit in on the hearings with the Governmental Affairs Committee, which we always agreed to.

But they were very uneasy about that independent look by the Governmental Affairs Committee. Nevertheless, I think the ability of the committee to do that, and its willingness to commit its staff and resources to doing that, is critical. Otherwise, you do have situations where the authorizing committee is just not quite willing to take that really cold, hard, objective look at how certain programs are operating.

I do not want to speculate as to all the reasons why that may occur, but unquestionably it does occur, and I think the Governmental Affairs role is a very important safety valve.

Mr. **Mann**. The criticism is of two sorts. Either it is that no one is doing the overseeing because no single unit in Congress has the sole and clear responsibility for doing it—and then, after the fact, we complain that oversight was not done; or, alternatively, publicity associated with oversight offers political advantage, and then everyone in Congress wants a piece of the action. When complaints come from downtown that they spend all of their time saying the same thing on Capitol Hill, why doesn't Congress get its act together so it can be done more efficiently, it is important to recognize that an effective oversight system is not without costs. On balance, jurisdictional overlap and redundancy increases the likelihood that someone on Capitol Hill will be paying attention.

Just as it is important to avoid joint House-Senate committees and maintain some independence and competition in the intelligence oversight areas, so too is it true as a more general proposition. That does not mean that as new issues evolve, it is not worthwhile straightening out committee jurisdictions and the like, but when it comes to matters of oversight, I would say that having at three separate cracks (appropriations, authorization, and oversight committees) in each House is a big plus.

Mr. **Brand**. I would point out one historical example. This one I was on the receiving end of. I was a counsel to a major defense contractor. Most of the major defense contracting reforms came out of a committee which, most would say, had no jurisdiction over the defense contracting in the face of seven or eight Armed Services and Appropriations committees that some would say remain conspicuously ignorant and out of the loop on what was going on in the Defense Department. That is because, inevitably over time, you develop a client-attorney relationship with the agency that you fund or authorize.

Sometimes it takes, again, a fresh look to break that institutional relationship. And without commenting one way or the other on whether it was good or bad, it is a fact that most of the major impetus for reform came out of a committee that a lot of members and others would say had no jurisdiction whatsoever over the Defense community.

Mr. **Leary**. Let me turn now to the confirmation process for a moment. Again, we have in our review of the confirmation process as it related to HUD officials in the last decade every person who was presented to the committee except two who were confirmed. The process varies from committee to committee as to how the committee reviews.

I believe, again Mr. Wegman, in your statement you indicated that you had received testimony that HUD had become a dumping ground for political aspirants. The subcommittee is concerned about what might be done to improve that process to help Congress ensure that people that the President presents to the Senate for confirmation are competent, qualified people who are interested in the mission of the agency, as Congress intends it, while recognizing the realities of wanting to let the President have who he or she wants.

On the other hand, we are concerned that that process ought to be perhaps more effective, and how it is that Congress can improve that.

Do any of you have comments on that?

Mr. **Wegman**. Your question recalls an experience that we had at the Governmental Affairs Committee while I was there. I can tell you what we did about it. I think it was partially successful, but not wholly successful.

The experience concerned President Carter's first OMB Director, Bert Lance, who was confirmed by our committee on a fast-track basis in order to get all the appointments in place by Inauguration Day. The committee handled that particular nomination a lot more hastily than I think a lot of Members and staff were comfortable with, and ultimately everyone came to rue what happened.

Six or 7 months later Mr. Lance was back before the committee for another review of the qualifications for office that should have taken place prior to the original confirmation. And after another round of hearings, ultimately he resigned, as you may recall.

After that experience, the committee adopted some very detailed confirmation procedures, including a requirement that before any individual is confirmed for a position that the committee make an affirmative finding that the individual is qualified by background and experience for the position to which he has been nominated.

I think the committee had hoped that that would lead to the kind of in-depth inquiry that I think your question suggests. And it did work that way on a number of occasions, but it certainly was not an unqualified success. Members and staff on occasion found it very difficult to make what is inherently a somewhat subjective judgment about the qualifications of individuals for a position.

Members were much more comfortable making a judgment either aye or nay about an individual on the basis of financial qualifications or the existence of some financial irregularity. It was also easier to make a judgment if there was any evidence of malfeasance, whether it was ethical or otherwise. Somehow these matters were viewed as a bit less subjective, and a little bit easier for members to make judgments about.

Members were very uneasy about rejecting someone who was clean financially, clean ethically, but did not seem to be quite up to snuff on the basis of background experience or personal competence. Nevertheless, recognizing the difficulty of making these judgments, I think it is worth a try, and I think other committees would be well advised to put something like the Governmental Affairs rule into their rules and make a serious stab—we certainly did at the committee—at really exploring thoroughly on individuals' background, experience, and qualifications for the position to which he or she was nominated, and prepare staff reports on whether or not the affirmative standard has been met.

Mr. LEARY. Any other comments?

Mr. ROCKMAN. Yes. Quite frankly, there is no error-free process by which confirmation proceedings can judge nominees, and I would be a little reluctant to suggest any iron-clad criteria because mostly one has to really go on one's judgments of the individual appearing before the appropriate committees.

But I think we have had a surplus of people who have not been fundamentally qualified for positions they have held in the executive branch. We have had many more political positions that have been held up in the executive for a long time for political review. It seems to me to be appropriate for the Senate not to be tempted to have early or quick reviews just simply because there is a need to fill the post. I think there the need to judge qualifications and competence is very, very important.

Most often what tends to occur, as I think Tom Mann has pointed out, is either a case where there is a very strong ideological difference, and that raises an issue, or a case in which there are some embarrassments and perhaps flaws in the individual backgrounds sometimes of a relatively minor sort when the real issue perhaps is the individual's competence to hold the job.

I might suggest that one of the things that in the long run Congress should be giving some attention to is whether we have too many political appointees in the departments. I think there is a good case that this is so.

Mr. **Leary**. That was a follow-up question I had in mind. Mr. Dwight Ink, who was the original Assistant Secretary for Administration, suggested that perhaps that is a position that ought to be a career position. I believe in Mr. Gilliam's testimony this past week he suggested that a number perhaps of the deputy assistant secretary positions ought to be career instead of political.

Is it your view that perhaps HUD—Yes?

Mr. **Brand**. Could I just on that last point mention that it is not always the allegedly incompetent person who gives vent to a congressional oversight controversy. Your namesake, James Watt, no one would have accused him of being unfit to serve. The issue with Congress was whether he implemented the laws Congress passed in the way Congress intended him to, and whether he ran the agency consistent with the policy directives that were embodied in those laws. So that to make competence the sine qua non of nomination is not, quite frankly, going to root out every last problem that results from good congressional oversight.

I do not think the nomination process is a particularly salient way to predict where the problems would arise, because some of the most competent people have been, quite frankly, people with whom Congress has had the deepest issues not over whether they are competent but whether they are following the laws as Congress intended.

Mr. **Fogel**. There is no doubt that if you referred back to the previous reports we have done, and if you refer to the Volcker Commission and other studies, that a lot of people of all political persuasions are becoming more and more concerned with the extent of political appointees in agencies.

I think there is a real question as to whether the number that we have is necessary to either effectively develop policies that the Secretary and the Department want, or to effectively carry them out.

There probably are too many political appointees. I think we need to look at that fairly carefully over the next couple of years in all the executive branch agencies.

Mr. **Leary**. I just have one more question myself so that we can get on with our day, although we might submit some additional questions to you following the hearing, and we would appreciate your continued assistance.

My question, Mr. Fogel, gets back to your service that GAO offers the management review. Also, I asked at one of our earlier hearings—I believe it was our OMB hearing—we were discussing the management services, if you will, that OMB provides, the "M" in "OMB," and put to that panel whether management and budget ought to be continued to be kept together in OMB.

Two of the witnesses suggested that the management ought to be pulled away into a separate office of management. Another, Mr. Heclo, suggested that perhaps the management side ought to be in the legislative branch and that perhaps additional funding ought to be given to GAO to be able to provide management review and in order to help an agency evaluate its management systems.

It would seem to me that perhaps that sort of suggestion would also help Congress in its confirmation procedures in helping to understand what a job ought to entail so that it could review somebody nominated for that position. But in any event, in helping Congress understand and help the agency understand how it ought to properly manage its programs, do you believe that the GAO program as it is or as it could be would be appropriate for that? Or do you believe it ought to be in the executive branch?

Mr. **Fogel**. I think that the executive branch ought to have the primary responsibility. It manages the programs. I do not think you ought to take the "M" out of "OMB." It is not too effective in OMB, but what needs to be done is to have a closer relationship between the budget process and the management process at OMB.

I ask this question rhetorically: If it is not too effective and does not have much clout right in the agency where you are dealing with the budget, how do those people who want a separate management agency ever think that it will have any clout? In our view, it would be a nice, academic office that would even get less done than is done in OMB.

In terms of the role that GAO can play, we work for the Congress. I think whether you are doing management reviews, investigations, or program evaluations, whatever you want to call it, we try to develop strategies and approaches to work with the committees to develop a line of inquiry that improves your ability to exercise oversight or get good information to enact legislation.

If through management reviews we can provide more information on the confirmation process, we will do that. In fact, we have done that on occasion. Where we have done agency management reviews, some of our committee staff have talked to our agency before confirmation and have developed a whole line of inquiry that they want to ask a potential nominee. A lot of times, the nominees do not want to commit themselves one way or another to what they want to do, but it certainly lets the nominees know that the committee is concerned about some things, and oftentimes those committees have said we want you to come back—"you" being the potential head of the agency, or whatever—and report to us on what you are doing to implement the GAO recommendations, or they will ask us to go back in and give the committees a report card on how well the agencies are operating.

But I do not think the line of responsibility that exists now between us and the executive branch should be changed. We should be part of the legislative branch and exercise oversight and report to you. I do not think we ought to have operating responsibilities.

Mr. **Mann**. I think this is an area where Congress could easily overstep its authority and its competence. No one doubts the constitutional authority of the Congress on matters pertaining to budgets, as well as on statutes and legislative authority for programs. Management, on the other hand, is inherently an executive responsibility, and it seems to me all of your efforts should see to the appropriate oversight of those systems, but not a duplication or a second-guessing of them.

Mr. **Leary**. On behalf of the subcommittee, we thank you very much for being here today.

[Whereupon, at 12:50 p.m., the hearing was adjourned.]

[Response to written questions follow:]

DONALD W. RIEGLE, JR., MICHIGAN, CHAIRMAN

ALAN CRANSTON, CALIFORNIA
PAUL S. SARBANES, MARYLAND
CHRISTOPHER J. DODD, CONNECTICUT
ALAN J. DIXON, ILLINOIS
JIM SASSER, TENNESSEE
TERRY SANFORD, NORTH CAROLINA
RICHARD C. SHELBY, ALABAMA
BOB GRAHAM, FLORIDA
TIMOTHY E. WIRTH, COLORADO
JOHN F. KERRY, MASSACHUSETTS
RICHARD H. BRYAN, NEVADA

JAKE GARN, UTAH
JOHN HEINZ, PENNSYLVANIA
ALFONSE M. D'AMATO, NEW YORK
PHIL GRAMM, TEXAS
CHRISTOPHER S. BOND, MISSOURI
CONNIE MACK, FLORIDA
WILLIAM V. ROTH, JR., DELAWARE
NANCY LANDON KASSEBAUM, KANSAS
LARRY PRESSLER, SOUTH DAKOTA

STEVEN B. HARRIS, STAFF DIRECTOR AND CHIEF COUNSEL
LAMAR SMITH, REPUBLICAN STAFF DIRECTOR AND ECONOMIST

United States Senate
COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS
WASHINGTON, DC 20510-6075

May 22, 1990

Honorable Paul Adams
Inspector General
Department of Housing and Urban
Development
451 Seventh Street, S.W.
Washington, D.C. 20410

Dear Mr. Adams:

Thank you for your testimony at our hearing on Congressional oversight on May 8, 1990. Your insights were extremely valuable and will be helpful to my staff in developing and writing recommendations for the Subcommittee's report.

As I mentioned at the hearing, I am contacting you for follow-up information regarding questions that I did not get a chance to ask or which were not fully explored. My staff and I would also welcome any additional comments you wish to make to augment your testimony or written statement on this subject.

In that the Subcommittee staff is working towards a July deadline for completing the report, I would appreciate it if you could return your responses to them by no later than June 6, 1990. If you have any questions or problems with this request, please contact Janet Mascia of the Subcommittee staff on 202/224-6094.

My thanks again for helping make this such a successful and informative hearing.

Sincerely yours,

Bob Graham

Bob Graham
Chairman, HUD/Mod Rehab
Investigations Subcommittee

Attachment

1. Do you think that "quantitative screens" or measurable indicators could be established to help agencies and the Congress monitor program performance?

2. If so, could you list specifically what some of these indicators might be as they relate to HUD programs?

3. Should the development of such indicators be mandated in authorization legislation for HUD programs? If not mandated through legislation, what other ways could the Congress encourage agencies to develop these indicators?

4. Regarding the Senate's confirmation process, what is your opinion concerning the establishment of an advisory board, similar to the Askew Commission on Ambassadorial Appointments, for HUD nominees?

5. How would you envision such a board working?

6. Some people have suggested to us that housing legislation should include mandated, long-term evaluations of programs, and that HUD's research and evaluation office should be rebuilt and become more active. What are your thoughts about these suggestions?

7. Testimony given at our hearing suggested that the criteria for using the seven day letter to warn the agency head and Congress of "particularly serious or flagrant problems" is too vague. How should the criteria be better defined? Do you have any other recommendations on how to make this mechanism more useful to you and the Congress?

U.S. Department of Housing and Urban Development
Washington, D.C. 20410-4500

OFFICE OF INSPECTOR GENERAL

June 5, 1990

Honorable Bob Graham
United States Senate
Chairman, HUD/Mod Rehab
Investigations Subcommittee
Washington, DC 20510-6075

Dear Senator Graham:

This is in response to your May 22, 1990 letter regarding follow-up questions from the Congressional Oversight hearing on May 8, 1990.

Enclosed you'll find answers to the questions you posed in your letter.

We again thank you and the Subcommittee for the opportunity to discuss our feelings about this matter. Should you or your staff have any questions, please call me or John J. Connors, Deputy Inspector General, on 708-0430.

Sincerely,

Paul A. Adams
Inspector General

Enclosures

Question 1 Do you think that "quantitative screens" or measurable indicators could be established to help agencies and the Congress monitor program performance?

Answer 1 Absolutely. Quantitative screens or measurable indicators are already in place in many agencies, including HUD. For many years, including FY'90, HUD has established Regional Management Plans which track quantitative goals to measure performance. Also, in February 1986, President Reagan signed Executive Order 12552 which required each executive agency to establish a productivity improvement program. The executive order placed overall direction of the Federal Productivity Improvement Program with the Office of Management and Budget (OMB). OMB's Circular A-132 provides specific guidelines to Federal agencies with respect to developing and implementing productivity improvement programs. These programs are involved in tracking both output (i.e., quantity produced) and input (i.e., cost of resources required to produce output).

Question 2. If so, could you list specifically what some of these indicators might be as they relate to HUD programs?

Answer 2 There is really no limit, practically speaking, to the establishment of quantitative measurable indicators. The following are some examples applicable to HUD:

A. Collection of outstanding debt (e.g., multifamily mortgage notes)

B. Reduction of single-family acquired properties on hand

C. Processing of insurance endorsement requests

D. Sale of HUD-acquired multifamily housing properties

E. Processing of multifamily mortgage foreclosures

F. Number of housing voucher units under lease

G. Execution of Annual Contributions Contracts for approved housing voucher program applications

H. Processing of Section 202 Elderly or Handicapped Housing applications

Question 3	Should the development of such indicators be mandated in authorization legislation for HUD programs? If not mandated through legislation, what other ways could the Congress encourage agencies to develop these indicators?
Answer 3	The specific quantitative screens or measurable indicators that an agency would be required to meet should not be mandated in authorizing legislation because this might diminish an agency's administrative discretion and flexibility to adjust such indicators based on changing circumstances (e.g., availability of funding, agency's workload/resources, etc.). In addition, agencies might look upon such indicators as goals to be accomplished at any cost. Consequently, an agency may divert resources from important areas to other areas simply to meet performance indicators mandated by law. However, Congress should include provisions in the law requiring agencies to develop such performance indicators. This could be done by requiring an agency to develop an annual or longer-term operating plan with specific quantitative and performance indicators. The plan would be submitted to Congress and would be monitored by Congress through the normal oversight/appropriations process. The Office of Management and Budget should also be involved in the process. To the extent permissible under law, an agency's funding should bear some relationship to its ability to meet established performance indicators.
Questions 4&5	Regarding the Senate's confirmation process, what is your opinion concerning the establishment of an advisory board, similar to the Askew Commission on Ambassadorial Appointments, for HUD nominees? How would you envision such a board working?
Answers 4&5	Since we have no prior experience or conception of how an advisory board or commission operates, given our particular situation, we are not sure how it would work for HUD. The current process that is in place at HUD and other agencies seems to be operating effectively.
Question 6	Some people have suggested to us that housing legislation should include mandated, long-term evaluations of programs, and that HUD's research and evaluation office should be rebuilt and become

more active. What are your thoughts about these suggestions?

Answer 6 We fully agree that housing legislation should include mandated long-term evaluations of programs. However, we believe that Congress should specifically set-aside a certain percentage of appropriated funds for program evaluation. In addition, Congress should require agencies to segment their program evaluations so that particular aspects of a program can be evaluated on a shorter-term basis. We also agree that HUD's research and evaluation office should become more active.

Question 7 Testimony given at our hearing suggested that the criteria for using the seven day letter to warn the agency head and Congress of "particularly serious or flagrant problems" is too vague. How should the criteria be better defined? Do you have any other recommendations on how to make this mechanism more useful to you and the Congress?

Answer 7 The legislative history of Section 5(d) of the Inspector General Act makes it clear that the decision of what constitutes a serious or flagrant problem is to be made by the Inspector General. It has been suggested that the President's Council on Integrity and Efficiency (PCIE) issue a policy statement in support of the legislative history of the seven day letter, and we would not be opposed to such a statement. However, it may be appropriate for Congress to clarify the issue rather than the PCIE. An amendment to the Act requiring the Inspector General to submit the report directly to Congress 7 days following the submission to the agency head, would clear up any misinterpretation.

DONALD W RIEGLE JR MICHIGAN CHAIRMAN

ALAN CRANSTON CALIFORNIA
PAUL S SARBANES MARYLAND
CHRISTOPHER J DODD CONNECTICUT
ALAN J DIXON ILLINOIS
JIM SASSER TENNESSEE
TERRY SANFORD NORTH CAROLINA
RICHARD C SHELBY ALABAMA
BOB GRAHAM FLORIDA
TIMOTHY E WIRTH COLORADO
JOHN F KERRY MASSACHUSETTS
RICHARD H BRYAN NEVADA

JAKE GARN UTAH
JOHN HEINZ PENNSYLVANIA
ALFONSE M D'AMATO NEW YORK
PHIL GRAMM TEXAS
CHRISTOPHER S BOND MISSOURI
CONNIE MACK FLORIDA
WILLIAM V ROTH JR DELAWARE
NANCY LANDON KASSEBAUM KANSAS
LARRY PRESSLER SOUTH DAKOTA

STEVEN B HARRIS STAFF DIRECTOR AND CHIEF COUNSEL
LAMAR SMITH REPUBLICAN STAFF DIRECTOR AND ECONOMIST

United States Senate
COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS
WASHINGTON, DC 20510-6075

May 22, 1990

Mr. Frederick Kaiser
Government Division
Room LM-303
Madison Building
Congressional Reserach Service
Washington, D.C. 20540

Dear Mr. Kaiser:

Thank you for your testimony at our hearing on Congressional oversight on May 8, 1990. Your insights were extremely valuable and will be helpful to my staff in developing and writing recommendations for the Subcommittee's report.

As I mentioned at the hearing, I am contacting you for follow-up information regarding questions that I did not get a chance to ask or which were not fully explored. My staff and I would also welcome any additional comments you wish to make to augment your testimony or written statement on this subject.

In that the Subcommittee staff is working towards a July deadline for completing the report, I would appreciate it if you could return your responses to them by no later than June 6, 1990. If you have any questions or problems with this request, please contact Janet Mascia of the Subcommittee staff on 202/224-6094.

My thanks again for helping make this such a successful and informative hearing.

Sincerely yours,

Bob Graham

Bob Graham
Chairman, HUD/Mod Rehab
Investigations Subcommittee

Attachment

1. Do you think that "quantitative screens" or measurable indicators could be established to help agencies and the Congress monitor program performance?

2. If so, could you list specifically what some of these indicators might be as they relate to HUD programs?

3. Should the development of such indicators be mandated in authorization legislation for HUD programs? If not mandated through legislation, what other ways could the Congress encourage agencies to develop these indicators?

4. Regarding the Senate's confirmation process, what is your opinion concerning the establishment of an advisory board, similar to the Askew Commission on Ambassadorial Appointments, for HUD nominees?

5. How would you envision such a board working?

6. Some people have suggested to us that housing legislation should include mandated, long-term evaluations of programs, and that HUD's research and evaluation office should be rebuilt and become more active. What are your thoughts about these suggestions?

7. Testimony given at our hearing suggested that the criteria for using the seven day letter to warn the agency head and Congress of "particularly serious or flagrant problems" is too vague. How should the criteria be better defined? Do you have any other recommendations on how to make this mechanism more useful to you and the Congress?

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

June 6, 1990

TO : Honorable Bob Graham, Chairman
HUD/Mod Rehab Investigations Subcommittee
Senate Committee on Banking, Housing, and Urban Affairs

FROM : Frederick M. Kaiser FMK
Specialist in American National Government
Government Division

SUBJECT : Responses to Followup Questions from Hearings on Congressional Oversight

This memorandum provides followup information to questions that emerged from the hearings on congressional oversight, held on May 8, 1990 before the HUD/Mod Rehab Investigations Subcommittee. Based on my testimony, which focused on oversight in general and inspector general (IG) reporting to Congress in particular, the responses concentrate on two of the questions (as numbered in your letter of May 22, 1990):

3. Requiring certain measurable indicators in public law or otherwise to help Congress monitor programs; and

7. Clarifying the statutory langauge--"particularly serious or flagrant problems, abuses, or deficiencies"--that governs immediate reports from the inspector general to the establishment head and, in seven days, to Congress.

QUESTION 3. Should the development of such [measurable program] indicators be mandated in authorization legislation for HUD programs? If not mandated through legislation, what other ways could the Congress encourage agencies to develop these indicators?

RESPONSE

Congress possesses a number of distict techniques--statutory and nonstatutory--to control executive actions. [1] These can range from ordering an agency, such as the Department of Housing and Urban Affairs (HUD), to develop certain indicators for use in monitoring program performance; to imposing them in statute directly; to encouraging the agency indirectly to adopt them. In addition, Congress can require that the agency, if it is to develop new monitoring standards, consult with outside parties, such as an advisory committee or the General Accounting Office (GAO).

Statutory Devices

The techniques available to Congress range across a variety of statutory devices:

---

[1] These techniques, it is important to note, are different than the so-called "legislative veto," which was declared unconstitutional by the Supreme Court in Immigration and Naturalization Service v. Chadha, 462 U.S. 919 (1983) and subsequent summary affirmances. The legislative veto allowed Congress acting unilaterally--through both chambers alone, through one house, or through a committee--to override an executive action. The Court held that this violated the presentment clause of the Constitution, which requires that legislative actions that are "essentially legislative in purpose and effect" must be presented to the President for his signature. Congress may, of course, still issue directions, instructions, or urgings to the executive unilaterally, through committee reports, for instance; but these are not themselves legally binding on the executive.

For an extensive review of these methods, see U.S. Library of Congress. Congressional Research Service. Congressional Control of Executive Actions: Alternatives to the Legislative Veto. Report No. 83-227 GOV, by Frederick M. Kaiser, December 27, 1983. Washington, 1983.

--Program or agency authorizations: These could impose a permanent requirement in public law, unless a "sunset" provision were included or the authorization period for the monitoring indicators or the program were otherwise limited to a set time period. The authorization could also be used to set up a temporary pilot program, which, after completion, could be evaluated by the Department, its Inspector General (IG), and/or GAO.

--Program or agency appropriations: These would impose a temporary requirement on the agency, usually for one fiscal year (or less, if enacted after the fiscal year has already begun). They might be used for erecting a pilot program or for directing the agency itself to develop the monitoring standards. Again, mandatory followup evaluations by the Department itself, the IG, or GAO could be written into the appropriations act.

--Joint resolutions of approval or disapproval: Once passed by both chambers of Congress and signed by the President (or his veto overridden), joint resolutions (of approval or disapproval) become public law. These mechanisms can be used to permit Congress to rule on new indicators that the Department would be ordered to develop; after drafting them, they would be sent to the Congress for approval or disapproval, possibly under a specified time frame (sixty or ninety days, for instance) and expedited procedures.

Under a joint resolution of approval, the new indicators would not go into into effect unless and until Congress passed a joint resolution approving them and the President signed it (or his veto was overridden). Although the joint resolution of approval is not a legislative veto per se, it can become the functional equivalent of one, because it allows a single house of Congress to nullify an executive action simply by not acting on it or by voting against the proposal.

Under a joint resolution of disapproval, the new monitoring indicators would go into effect automatically after a certain time period, unless Congress passed a joint resolution disapproving them and it was signed by the President or his veto overridden. Depending on circumstances, the President might well veto a joint resolution disapproving new monitoring indicators that had been submitted by his Secretary of HUD and endorsed by his Office of Management and Budget. In this situation, consequently, Congress would need a two-thirds vote in each chamber to reject the President's veto.

--Report-and-wait requirements: Through a public law, Congress could direct the Department to develop new monitoring indicators and submit them to the appropriate committees for review but not for official approval, as under the joint resolution. The new indicators would go into effect after a set time period (sixty or ninety days, for instance). This delay would allow Congress the opportunity to examine the new indicators before they became operational and, if they were found defective, to enact legislation overturning them, modifying them, or prohibiting their implementation. Short of these actions, the time delay would permit the oversight panels in Congress the opportunity to voice any disapproval to the Department, which might then modify the proposed indicators on its own.

Nonstatutory Devices

The statutory devices could compel an agency to develop the indicators or to implement those imposed on it by public law. An agency can also be convinced or instructed to develop such monitoring devices through various nonstatutory techniques. Even though such directives would not be formally binding on the Department, they could encourage it to act with sufficient congressional support behind them.

The nonstatutory techniques include:

--a sense of the Congress resolution approved by a concurrent resolution;

--a sense of the House or Senate resolution approved by a simple resolution from the appropriate chamber; and

--instructions, directives, or expectations from certain congressional panels; these could be accomplished through reports accompanying the program's or the agency's authorization or appropriation or through reports based on oversight inquiries conducted by subcommittees or by the House Government Operations or Senate Governmental Affairs Committees.

Approaches and Sources

The approaches, moreover, can vary in terms of what units and sources are brought into the process and the degree of discretion allowed to the department. A number of possible combinations exist.

--Congress might proceed independently through enactment of a public law.

--Congress might act in conjunction with the agency; for instance, a law could require the agency to develop new rules which Congress would have to approve or disapprove (through a joint resolution).

--Congress might act independently or in conjunction with the agency, but only after an advisory committee, the HUD Inspector General, or the General Accounting Office has issued recommendations for the new monitoring indicators.

--The Department might be directed to act separately under a statutory mandate, requiring it to develop the new indicators on its own or following recommendations from an advisory committee or another body; the new regulations could also be submitted to Congress under a report-and-wait provision in the law.

--The Department might be urged to act separately under a sense-of-the Congress concurrent resolution, a sense-of-the-Senate or -House simple resolution, or a set of instructions in a congressional committee or subcommittee report.

QUESTION 7. Testimony given at our hearing suggested that the criteria for using the seven-day letter to warn the agency head and Congress of "particularly serious or flagrant" problems is too vague. How should the criteria be better defined? Do you have any other recommendations on how to make this mechanism more useful to you and the Congress?

RESPONSE

The 1978 Inspector General Act provides that:

> Each Inspector General shall report immediately to the head of the establishment involved whenever the Inspector General becomes aware of particularly serious or flagrant problems, abuses, or deficiencies . . . The head of the establishment shall transmit any such report to the appropriate committees or subcommittees of Congress within seven calendar days, together with a report by the head of the establishment containing any comments such head deems appropriate. (5 U.S.C. Appendix 5(d))

Infrequent IG Reporting of "Particularly Serious or Flagrant Problems"

This provision has rarely been activated. In fact, a survey by the House Government Operations Committee found that by 1986, eight years after passage of the generic Inspector General Act, only eight reports had been made, by six IGs. 1/ Earlier this year, twelve years after passage of the Act, a review by the Senate Subcommittee on Oversight of Government Management discovered that a total of only eleven such immediate reports had been made. 2/ This averages about one per year for all the IGs collectively.

At the May 8, 1990 hearings before the HUD Investigations Subcommittee, moreover, the current and former Inspectors General at the Department of Housing

---

1/ U.S. Congress. House. Committee on Government Operations. The Inspector General Act of 1978: A 10-Year Review. House Report No. 100-1027, 100th Congress, 2d Session. Washington, U.S. Government Printing Office, 1988. p. 22 and 23.

2/ Letter from Carl Levin, Chairman, Subcommittee on Oversight of Government Management, Committee on Governmental Affairs, U.S. Senate, to William Diefenderfer III, Chairman, President's Council on Integrity and Efficiency, March 5, 1990. p. 2.

and Urban Development testified that no immediate reports on particularly serious or flagrant problems have been filed during their tenures. 3/ Such reports have not been made, despite the apparent seriousness and flagrancy of the problems and abuses at the Department; that is, the same significant problems continued over a number of years, despite repeated criticisms and recommendations for corrective action in the IG semiannual reports.

Underlying Problem of Statutory Vagueness

The infrequent reporting on "particularly serious or flagrant problems, abuses, or deficiencies" is, in part, due to the vagueness of the statutory language. (Another probable reason for the lack of use is an unwillingness of IGs to use a power--the report would automatically go to Congress--that might be expected to jeopardize their relationship with upper management at an agency.4/)

The phrase is defined neither in the law nor in the accompanying congressional committee reports, 5/ other than a brief paragraph in the House Government Operations Committee report. And this reference only recognizes what the provision does not call for:

3/ Paul A. Adams, Inspector General, Department of Housing and Urban Development, and Charles L. Dempsey, former Inspector General, Department of Housing and Urban Development. Testimony before the Senate Subcommittee on HUD/Mod Rehab Investigations, May 8, 1990.

4/ Ibid.

5/ U.S. Congress. Senate. Committee on Governmental Affairs. Establishment of Offices of Inspector and Auditor General in Certain Executive Departments and Agencies; Report to Accompany H.R. 8588. Senate Report No. 95-1071, 95th Congress, 2d Session. Washington, D.C., U.S. Government Printing Office, 1978. p. 33; and U.S. Congress. House. Committee on Government Operations. Establishment of Offices of Inspector General in Certain Executive Departments and Agencies; Report to Accompany H.R. 8588. House Report No. 95-584, 95th Congress, 1st Session. Washington, D.C., U.S. Government Printing Office, 1977. p. 3 and 13-14.

> It does not require that all matters reported to the agency head be automatically reported to the Congress, nor does it prescribe the amount of detail to be furnished when reports are required. It does not contemplate reporting of unsupported allegations. 6/

There are no explicit criteria or standards in these sources to guide what should be reported under the rubric of "particularly serious or flagrant problems, abuses, or deficiencies." Thus, there is no clear, precise guidance for what, according to the House Government Operations Committee, was intended "to insure that agency heads and the Congress are kept promptly informed of particularly important matters which should have their attention." 7/

Options for Improvement

Certain steps could be taken to help clarify the meaning of the language and better equip the IGs to put this reporting provision into operation. These would combine pre-existing attempts with new approaches and combine Congress' expectations, needs, and capabilities with the executive's.

A preliminary step could be to request that the General Accounting Office (GAO) examine the (rare) actual use of this provision, determining what specific problems, abuses, and deficiencies activated it. GAO could also examine situations in which IGs did not immediately report wrong-doing that, at least in hindsight, appeared to meet a common understanding of "particularly serious or flagrant" problems.

Congress could then examine the GAO findings along with efforts of the executive in this and related matters. Recently, for instance, the President's Council on Integrity and Efficiency (PCIE) developed "Suggested Criteria and

---

6/ House Government Operations Committee, Establishment of Offices of Inspector General, p. 13-14

7/ Ibid., p. 13.

Procedures for Early Warning Notifications." 8/ These appear to be useful steps in the right direction; they recognize, for instance, problems inherent in trying to set uniform standards for what may not be comparable problems among different departments and agencies or among different kinds of programs.

These suggested criteria, however, reveal a problem of their own and with attempts to substitute synomyms for the concept of "particularly serious or flagrant" problems, abuses, or deficiencies. In stating the early warning goals, the criteria call for the IG to alert the administration to "major problems which . . . represent egregious waste, fraud, abuse or mismanagement." 9/ "Egregious," defined as "remarkably or extraordinarily flagrant," 10/ however, might connote a more exacting standard--a higher threshold--for notification than does "particularly . . . flagrant." This interpretation might result, therefore, in even less reporting than under the existing statutory language.

In conjunction with the PCIE suggested criteria, Congress might look at the Attorney General's guidelines for parallel matters. Of particular relevance are the criminal investigation guidelines, 11/ which help to determine differences among levels of investigations, that is, which factors and criteria

---

8/ U.S. President's Council on Integrity and Efficiency. Suggested Criteria and Procedures for Early Warning Notifications. Washington, D.C., Office of Management and Budget. February 26, 1990.

9/ Ibid., Attachment, p. 1. See also, House Government Operations Committee. The Inspector General Act of 1978: A 10-Year Review, p. 22-23.

10/ The American College Dictionary. Random House, New York, 1970. p. 385.

11/ U.S. Attorney General. Guidelines on General Crimes, Racketeering Enterprise and Domestic Security/Terrorism Investigations (issued March 7, 1983). In: Department of Justice Manual. Clifton, New Jersey, Prentice Hall Law and Business, 1988 Supplement. vol. 2, Title 1-303B, p. 1-219 to 1-228.

result in a preliminary inquiry and which ones cause it to expand (into a full investigation) or expire. These guidelines could help in setting criteria and standards to determine the seriousness of the wrong-doing as well as the credibility of the allegations and evidence for IG reporting.

Along with these, Congress might want to compare past IG reports to the Attorney General "whenever the Inspector General has reasonable grounds to believe there has been a violation of Federal criminal law." 12/ These reports are not required to be sent to the establishment head or to Congress. But some of these reported violations, conceivably, constitute "particularly serious or flagrant" problems and abuses in an agency or in the administration of its programs. 13/ Consequently, they might prove a valuable source of information in setting guidelines for IG immediate reporting of such problems. The names of individuals and locations of the crimes, incidentally, could be redacted--removed or, literally, covered over--from the IG reports to the Attorney General. This would preserve the confidentiality of the IGs' communications to the Attorney General without withholding information about types of crimes, abuses, and misconduct that Congress could use to develop criteria and standards in this matter.

12/ 5 U.S.C. Appendix 4(d).

13/ See House Government Operations Committee, The Inspector General Act of 1978: A 10-Year Review, p. 27-28.

DONALD W RIEGLE JR MICHIGAN CHAIRMAN

ALAN CRANSTON CALIFORNIA
PAUL S SARBANES MARYLAND
CHRISTOPHER J DODD CONNECTICUT
ALAN J DIXON ILLINOIS
JIM SASSER TENNESSEE
TERRY SANFORD NORTH CAROLINA
RICHARD C SHELBY ALABAMA
BOB GRAHAM FLORIDA
TIMOTHY E WIRTH COLORADO
JOHN F KERRY MASSACHUSETTS
RICHARD H BRYAN NEVADA

JAKE GARN UTAH
JOHN HEINZ PENNSYLVANIA
ALFONSE M D AMATO NEW YORK
PHIL GRAMM TEXAS
CHRISTOPHER S BOND MISSOURI
CONNIE MACK FLORIDA
WILLIAM V ROTH JR DELAWARE
NANCY LANDON KASSEBAUM KANSAS
LARRY PRESSLER SOUTH DAKOTA

STEVEN B HARRIS STAFF DIRECTOR AND CHIEF COUNSEL
LAMAR SMITH REPUBLICAN STAFF DIRECTOR AND ECONOMIST

United States Senate
COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS
WASHINGTON, DC 20510-6075

May 22, 1990

Mr. Richard Fogel
Assistant Comptroller General
U.S. General Accounting Office
441 G Street, N.W.
Rm 3858
Washington, D.C. 20548

Dear Mr. Fogel:

Thank you for your testimony at our hearing on Congressional oversight on May 8, 1990. Your insights were extremely valuable and will be helpful to my staff in developing and writing recommendations for the Subcommittee's report.

As I mentioned at the hearing, I am contacting you for follow-up information regarding questions that I did not get a chance to ask or which were not fully explored. My staff and I would also welcome any additional comments you wish to make to augment your testimony or written statement on this subject.

In that the Subcommittee staff is working towards a July deadline for completing the report, I would appreciate it if you could return your responses to them by no later than June 6, 1990. If you have any questions or problems with this request, please contact Janet Mascia of the Subcommittee staff on 202/224-6094.

My thanks again for helping make this such a successful and informative hearing.

Sincerely yours,

Bob Graham
Chairman, HUD/Mod Rehab
Investigations Subcommittee

Attachment

1. Do you think that "quantitative screens" or measurable indicators could be established to help agencies and the Congress monitor program performance?

2. If so, could you list specifically what some of these indicators might be as they relate to HUD programs?

3. Should the development of such indicators be mandated in authorization legislation for HUD programs? If not mandated through legislation, what other ways could the Congress encourage agencies to develop these indicators?

4. Regarding the Senate's confirmation process, what is your opinion concerning the establishment of an advisory board, similar to the Askew Commission on Ambassadorial Appointments, for HUD nominees?

5. How would you envision such a board working?

6. Some people have suggested to us that housing legislation should include mandated, long-term evaluations of programs, and that HUD's research and evaluation office should be rebuilt and become more active. What are your thoughts about these suggestions?

7. Testimony given at our hearing suggested that the criteria for using the seven day letter to warn the agency head and Congress of "particularly serious or flagrant problems" is too vague. How should the criteria be better defined? Do you have any other recommendations on how to make this mechanism more useful to you and the Congress?

GAO
United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

July 20, 1990

The Honorable Bob Graham
Chairman, HUD/Mod Rehab
  Investigations Subcommittee
Committee on Banking, Housing,
  and Urban Affairs
United States Senate

Dear Mr. Chairman:

On May 8, 1990, GAO's Assistant Comptroller General Richard Fogel testified before your Subcommittee on congressional oversight. Subsequently, on May 22, you requested that our office provide additional information on certain issues raised during the hearing. Based on discussions and agreements reached with your office, we are providing information on the development and use of performance indicators and program evaluations.

In short, we believe that congressional and executive agency agreement on measures of program performance is a fundamental element for improved delivery of government services to the public. Agencies usually do have some performance indicators, but the ones used may not be adequate for management and oversight purposes.

Given that agencies generally track some indicators of performance, legislatively requiring their development is probably unnecessary and, further, would not necessarily ensure that appropriate indicators result. This end might best be achieved through the joint efforts of the agencies and the Congress to develop the most appropriate set of indicators to assess performance and efficiency.

Developing and monitoring performance measures should be accompanied by renewed attention to the value of program evaluation. Program evaluation is critical to assessing program performance and providing the impetus for needed adjustments in program planning and implementation.

We have not conducted specific analysis to determine whether, as a general rule, program evaluations should be legislatively mandated. The obligations of public service and good management principles assume reasonable efforts to measure performance and evaluate program success. However, in a budget-constrained environment, managers are unlikely to give these activities their highest priority.

Given this reality, legislatively mandated performance may be needed in certain instances. In any case, program evaluations, as well as appropriate performance indicators, will be useful only if agency officials use them to improve program management and the Congress uses them as a tool to improve oversight.

The specific questions you asked and our responses to them follow.

Question 1. Is it possible to establish "quantitative screens" or measurable indicators to help agencies and the Congress monitor program performance?

Some indicators are already in use by the agencies, although their effectiveness in tracking performance and correcting problems probably could be improved. For example, as we reported earlier this year, the Office of Personnel Management (OPM) currently has one or more performance measures and standards for most of its key products and services.[1] However, we noted that OPM has not adopted the full range of potential performance measures and standards for many key services. Further, we observed that while many performance measures exist at lower management levels, summarized information derived from these measures is provided to the directorate level for only a limited number of key services.

There are certain problems inherent in the development and use of indicators. Mr. Fogel touched on the most obvious in his testimony, that is, agency officials' understandable reluctance to create indicators and track performance against them given that the information can be used by others to criticize agency performance.

In addition, program elements that are the easiest to measure may not be the best indicators of program performance. For example, HUD Under Secretary Alfred DelliBovi suggested that Project HOPE's effectiveness will be measured, in part, by the number of low- to moderate-income persons who are able to become homeowners -- a number that would be a simple and straightforward measure. But such a measure would omit a key component in assessing the performance of the program: the number of these homeowners who are able to retain their homes over the years.

---

[1] Office of Personnel Management: Better Performance Information Needed (GAO/GGD-90-44, Feb. 7, 1990).

It may not be desirable to produce indicators for all measurable aspects of agency programs. For example, in the report on OPM performance measurement, we identified 24 measurable products or services, potentially capable of being measured in 4 areas: timeliness, quality, efficiency, and customer satisfaction. Because developing indicators and tracking data are resource-consuming, we suggested that OPM consider the most important products and services and the most important performance dimensions for each, the costs of tracking and reporting them, and monitor the greatest number of the most important functions and services that costs will allow.

In his testimony, Mr. Fogel emphasized the need for Congress to engage in a continuing dialogue with the agencies and to press the agencies to develop performance and output measures. Given the resources needed to develop indicators and track performance and their importance for program management and oversight, a cooperative effort between the agencies and the Congress to develop those indicators seems appropriate.

Question 2. What are some indicators that could be used for programs at the Department of Housing and Urban Development (HUD)?

Because of the limited amount of time to respond to your request, we were not able to conduct an in-depth review of HUD's use of performance indicators. Currently, HUD is proceeding with the development of a set of performance indicators as part of an overall evaluation of HUD operations. In the early fall, we anticipate issuing a report on HUD's plans and progress in addressing the problems that emerged over the past year. As part of our effort, we will present more detailed information on HUD's development of quantitative measures for monitoring program performance. This should be helpful for the full Committee in assessing HUD's intentions for monitoring program performance and areas requiring attention.

HUD has a number of systems that provide information about various aspects of program performance. As you are aware, the Inspector General's Report to the Congress, prepared semiannually, provides information such as the number of investigations conducted and reports issued and the number of material weaknesses identified, corrected, and outstanding. Additional information is provided in The Secretary's Semiannual Report to the Congress.

For internal tracking purposes, HUD recently published its first monthly Secretary's Management Report on Material Weaknesses. The report presents the findings of a completely new system developed to monitor completion of corrective actions and scheduled internal controls reviews. Each Assistant Secretary is required to provide monthly updates on his or her actions regarding material weaknesses. Of the 42 material weaknesses reported in 1989, 27 are scheduled to be eliminated in fiscal year 1990, according to the Secretary's first report.

One of the most important performance indicators, from the standpoint of congressional oversight, is now under consideration for use within the Federal Housing Administration (FHA). This involves tracking the capital reserve level of the Mutual Mortgage Insurance (MMI) Fund -- FHA's largest fund. Currently, the fund, while solvent, is considered to be not actuarially sound because its current reserve level is estimated to be only 1 percent of the total insurance in force. According to a study done by Price Waterhouse, the level of the reserve should not fall below 1.25 percent of the total insurance in force in order to withstand moderately adverse economic conditions.

Provided that the capital reserve level does not fall below 1.25 percent (or appear to be headed in that direction), oversight of this indicator alone may be sufficient for the Congress in gauging the health of the MMI Fund. If the reserve is less than this percentage, it is necessary to look at indicators that reflect activities at a less aggregated level. Indicators of the performance of and outlook for the MMI Fund would include trends in foreclosure rates, average loss on the sale of foreclosed properties, and foreclosed property inventory levels, as well as the sales-to-acquisition ratios.

The assessment of the performance of the Community Development Block Grant (CDBG) Program could be better accomplished through the use of appropriate indicators. Currently, performance in this program is measured in terms of the percentage of total dollars spent in each of three areas. More specifically, the latest information available shows that, of the more than $2 billion disbursed in fiscal year 1987, 91 percent was designated for low- to moderate-income beneficiaries, about 9 percent was spent for the elimination of slums and blight, and less than 1 percent was spent meeting "urgent needs." However, no formalized attempt has been made to measure the program accomplishments, considering, for example, the number of homes brought up to acceptable standards; the linear footage of sewers, sidewalks, streets, etc., improved; or the number of substandard structures demolished and the consequent reuse made of the property. Unlike the number of dollars disbursed, such measures are the real indicators of the program's achievements.

Recently, we issued a report that proposes a set of "outcome criteria" for evaluating the outcomes of housing and community development projects undertaken by public-private partnerships.[2] Outcome criteria relate to the effects of a given project, including tangible effects, such as the number of housing units built or amount of commercial space developed, and less tangible effects, such as changes in the environment for investment in a community. These criteria point to how well a project fulfills the housing or community development needs it is intended to address; how it affects the public sector, community residents, the private sector, and the partnership organization itself; and how much it costs in financial, political, or social terms. Thus, if we found that a given partnership project produced more low-income housing in a target neighborhood than would have been built in the absence of the partnership, we could conclude that the project had been a success.

Question 3. Should the development of such indicators be mandated in authorization legislation for HUD programs? If not, what other ways could the Congress encourage agencies to develop these indicators?

Legislatively requiring the development of performance indicators, in essence, duplicates an existing obligation of all public servants -- that is, the prudent management of government resources. And, as observed earlier, agencies generally do have some indicators against which they track program performance. The question is whether the indicators used are adequate to provide the agencies and the Congress critical program information.

Additional legislation requiring the development of program indicators will not necessarily ensure the development of appropriate indicators. We believe that this can be achieved through the cooperative efforts of the agencies and the Congress. Through such cooperation, indicators can be developed that show both the agencies and the Congress the extent to which the statutory goals of the program are being realized and whether funds are being spent in a lawful and efficient manner.

Finally, well-designed indicators will be useful only to the extent that program managers use the information as a management tool and that Congress employs them in a continued and vigilant effort to hold program managers accountable for their activities. Further, GAO supports a broad program of financial management reform, including the preparation of annual financial reports, to improve the accuracy and relevance of agency financial information.[3] The use of annual financial reports and annual oversight hearings by the appropriate committees will be useful in this regard.

---

[2] Partnership Projects: A Framework for Evaluating Public-Private Housing and Development Efforts (GAO/PEMD-90-9, May 22, 1990).

Question 4. Should housing legislation include mandated, long-term evaluations of programs, and should HUD's research and evaluation office be rebuilt and more active?

High-quality program evaluation provides sound information about what programs are actually delivering, how they are being managed, and the extent to which they are effective or cost-effective. As with performance indicators, the need for this type of information appears fundamental for effective program management and oversight.

Unfortunately, during the 1980s, program evaluation personnel were a tempting target to budget cutters because of tight resource constraints. As a result, there was a general erosion of agencies' capability to evaluate programs. HUD's capability to evaluate its programs did not escape this erosion. Further, HUD's decreased evaluative capability was in addition to the problems in coordinating efforts to evaluate programs, as we pointed out in our 1984 general management review of the agency.[4]

In 1987 and 1988, we emphasized the urgent need for a renewed commitment to program evaluation.[5] Specifically, we recommended that throughout the federal government top management needed to support several tasks: (1) increasing program evaluation capability; (2) establishing priorities so that the most critical program areas receive the necessary attention; (3) honestly reporting findings; and (4) using the information produced by the evaluations.

---

[3] Managing the Cost of Government: Building an Effective Financial Management Structure (GAO/AFMD-85-35 and GAO/AFMD-35A, February 1985).

[4] Increasing the Department of Housing and Urban Development's Effectiveness Through Improved Management, Vols. I and II (GAO/RCED-84-9, Jan. 10, 1984).

[5] Federal Evaluation: Fewer Units, Reduced Resources, Different Studies From 1980 (GAO/PEMD-87-9, Jan. 23, 1987) and Program Evaluation Issues (GAO/OCG-89-8TR, Nov. 1988).

The CDBG program stands as a good example of a program where the need for a long-term evaluation has not been met. Although CDBG has been in existence for 15 years and has disbursed more than $50 billion, whether the program has accomplished its goal of furthering the "establishment and maintenance of viable urban communities" is unclear.

Regarding the desirability of legislatively-mandated program evaluations, we have not conducted specific, in-depth analysis upon which to base a recommendation. There may be certain cases -- for example, experimental programs or those likely to have major social impacts -- where legislatively requiring evaluations could be appropriate.

However, while we are making no recommendations, we can offer several observations. Short of specific requirements, program managers are likely to reduce program evaluation activities when faced with reduced resources. The advantage of mandating program evaluations is that agencies, including HUD, are more likely to provide staff and other resources to carry them out. Moreover, such mandates provide the mechanism for Congress to direct funding specifically to these activities.

* * * * *

I hope that the information provided herein addresses your needs. If you need further assistance, please contact me at (202)275-5525.

Sincerely yours,

for Robert S. Procaccini
John M. Ols, Jr.
Director, Housing and
Community Development Issues

DONALD W. RIEGLE JR. MICHIGAN CHAIRMAN

ALAN CRANSTON CALIFORNIA
PAUL S. SARBANES MARYLAND
CHRISTOPHER J. DODD CONNECTICUT
ALAN J. DIXON ILLINOIS
JIM SASSER TENNESSEE
TERRY SANFORD NORTH CAROLINA
RICHARD C. SHELBY ALABAMA
BOB GRAHAM FLORIDA
TIMOTHY E. WIRTH COLORADO
JOHN F. KERRY MASSACHUSETTS
RICHARD H. BRYAN NEVADA

JAKE GARN UTAH
JOHN HEINZ PENNSYLVANIA
ALFONSE M. D'AMATO NEW YORK
PHIL GRAMM TEXAS
CHRISTOPHER S. BOND MISSOURI
CONNIE MACK FLORIDA
WILLIAM V. ROTH JR. DELAWARE
NANCY LANDON KASSEBAUM KANSAS
LARRY PRESSLER SOUTH DAKOTA

STEVEN B. HARRIS, STAFF DIRECTOR AND CHIEF COUNSEL
LAMAR SMITH, REPUBLICAN STAFF DIRECTOR AND ECONOMIST

United States Senate
COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS
WASHINGTON, DC 20510-6075

May 22, 1990

Mr. Bert Rockman
Senior Fellow
The Brookings Institution
1775 Massachusetts Ave., N.W.
Washington, D.C. 20036-2188

Dear Mr. Rockman:

Thank you for your testimony at our hearing on Congressional oversight on May 8, 1990. Your insights were extremely valuable and will be helpful to my staff in developing and writing recommendations for the Subcommittee's report.

As I mentioned at the hearing, I am contacting you for follow-up information regarding questions that I did not get a chance to ask or which were not fully explored. My staff and I would also welcome any additional comments you wish to make to augment your testimony or written statement on this subject.

In that the Subcommittee staff is working towards a July deadline for completing the report, I would appreciate it if you could return your responses to them by no later than June 6, 1990. If you have any questions or problems with this request, please contact Janet Mascia of the Subcommittee staff on 202/224-6094.

My thanks again for helping make this such a successful and informative hearing.

Sincerely yours,

Bob Graham

Bob Graham
Chairman, HUD/Mod Rehab
Investigations Subcommittee

Attachment

1. **Do you think that "quantitative screens" or measurable indicators could be established to help agencies and the Congress monitor program performance?**

2. **If so, could you list specifically what some of these indicators might be as they relate to HUD programs?**

3. **Should the development of such indicators be mandated in authorization legislation for HUD programs? If not mandated through legislation, what other ways could the Congress encourage agencies to develop these indicators?**

4. **Regarding the Senate's confirmation process, what is your opinion concerning the establishment of an advisory board, similar to the Askew Commission on Ambassadorial Appointments, for HUD nominees?**

5. **How would you envision such a board working?**

6. **Some people have suggested to us that housing legislation should include mandated, long-term evaluations of programs, and that HUD's research and evaluation office should be rebuilt and become more active. What are your thoughts about these suggestions?**

June 5, 1990

Ms. Janet Mascia
HUD/Mod Rehab Investigations Subcommittee
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510-6075

Dear Ms. Mascia:

I am responding to Senator Graham's request to follow up the testimony I gave to the subcommittee along with Mr. Mann on May 8th.

I do not believe that Mr. Mann plans to respond further, and I must emphasize that some of the questions require more detailed knowledge of the programs than I have and also more thought and study to respond properly to them than I am presently able to give within a relatively short time frame.

A general response to the first two questions that are posed -- can measurable indicators be established to monitor program performance and can such indicators be developed in regard to HUD programs -- is yes. A lot of experience in using such indicators in my own profession, however, as well as in witnessing how they are used in policy evaluations leads me to conclude that these indicators rarely, if ever, speak for themselves. They have to be understood in the framework of a broader web of evidence and indicators regarding the problems that the programs address. Their users, including Congress, must be sensitive to what the indicators are indicating and how they are analyzed, in order to best exploit the information they provide on program performance.

The problem that often is raised in using quantitative indicators is that the easiest and simplest, but not necessarily most valid, indicators are picked up, and the process then turns into bean-counting rather than meaningful analysis. That error is least likely if we have a clear articulation of what a program is supposed to achieve. The clearer the goals are, the easier it is to evaluate the implementation and administration of policy. If clear program goals cannot be articulated, the existence of quantitative indicators of performance will be seen within the agencies as busy work, the products of which fail to improve the performance of the agencies. Indicators, therefore, should be seen not only as a way for Congress to evaluate bureaucratic performance but as a means for helping the agencies improve their own work. Since the agencies operate the programs, they are usually most aware of how measurements ~~work or fail to~~ work. Consultation and cooperation with the Department of Housing and Urban Development is essential to developing meaningful indicators.

This leads me to conclude in respect to question 3, then, that it is best for Congress to encourage the agencies to develop indicators but to not mandate specific ones. Signals of the sort that Mr. Mann and I discussed in our testimony would help generate the perception that the Congress has a continuing interest in the performance of the programs. One of these signals is to increase communications between committee staff and evaluation and auditing units within HUD. Congressional interest will strengthen these units within the department. In HUD, liaison with the Office of Policy Planning and Evaluation under the Office of the Assistant Secretary for Community Development is likely to be helpful. I say this recognizing that Mr. Duboise Gilliam was the occupant of the deputy assistant secretary's office at the time these scandals were developing. Had Mr. Gilliam known that he was being watched and that the programs were going to be scrutinized, I think there is little doubt that the pattern of behavior would have looked different. For thorough analysis of the quantitative aspects of program performance, however, Congress still will want to take advantage of the independent position and expertise of GAO.

How much attention is given to making things work depends on people and politics. For Congress, developing the means to oversee programs is less difficult than generating the motivation to do it. Often that motivation, as Mr. Mann and I pointed out in our testimony, comes from threats to the programs themselves and from political opportunities. These, however, tend to trigger short term responses. The longer term program evaluation process requires careful but unobtrusive oversight. It further requires gaining some consensus on procedures for evaluating programs that are inherently controversial. Gaining that consensus requires agreement between the executive and the Congress in regard to program purposes and commitments.

In short, no system can guarantee that effective program evaluation will be done, and none can ensure that if it is done it will be used. Nevertheless, the best oversight occurs when there is interest in and knowledge of the programs and their administration on the Hill and agencies know that interest exists. I am afraid that little can be done to overcome incompetence or bad faith in agency leadership, but continued interest in evaluating the performance of programs on the congressional side should have some deterrent effects. Question 6 is closely related to these issues, and my response to both mandating long term evaluations of programs and rebuilding HUD's research and evaluation office is yes. Mandating long term evaluations almost necessarily requires refurbishing HUD's capacity which was neglected, even disdained, during the past administration. The specific design of the evaluations should come from within the agency, but consultation between committee staff and the evaluation units is important to the committee's ability to achieve a persisting monitoring capacity and to the evaluation office's ability to ensure its priority within the department.

Questions 4 and 5 about the personnel and the appointment process in HUD raise broader issues Traditionally, a few departments because of the prestige of their responsibilities, generally have had well qualified appointees across presidential administrations. While not problem free,

State, DOD, and Treasury tend to be especially attractive to the cream of any administration's nominees. Incidentally, in most European countries or Japan, the finance or treasury ministries and the foreign affairs ministries (somewhat less on the defense side) also tend to be the most important ministries and attract the most capable civil servants. These agencies are seen to be engaged in "high policy" whereas the principal domestic agencies are seen to be operating around routines set by statutory law. Very able people typically want to go where the action is. The action in foreign affairs, treasury, finance, and (up to now) defense is pretty constant and high. In many of the domestic agencies, it is quite variable.
During the Johnson administration and at least through most of the first term of the Nixon administration, there was a commitment to HUD programs, and my impression of the quality of the appointees was that they were very good on the whole. Once the program commitments began to dissipate, the attractiveness of the agency began to sink. We all know the litany of obstacles preventing an assured supply of well-qualified appointees, from relatively low salaries to an overabundance of ethics laws. In the absence of commitments to the programs, it is hard to attract highly competent people from the outside. Moreover, the Reagan and Carter administrations seemed to select too many appointees who could not get along with the career bureaucracy. And, given the lack of commitment to, indeed the hostility of the Reagan White House toward HUD's program objectives, it is not in the least surprising that many of the appointees at HUD reflected that attitude. They were often selected for that reason.

I have some skepticism as to how a personnel advisory board would operate in domestic policy areas where one person's definition of incompetence is someone else's definition of differing policy priorities. On the face of it, with only a few exceptions, the appointees at HUD were not without seemingly proper backgrounds, or at least those which passed for such in prior administrations. What was apparently different was a lack of belief in the missions of the agency which, of course, was an attitude that originated in the White House.

The obvious way out of this problem is to resist the growth of presidential appointments in the agencies beyond the relatively small number that actually are needed to give direction. We have seen this growth not simply because expansion gives each incoming administration more payoffs in the form of patronage, but because there is a prevalent attitude in the White House (far less in the Bush White House than in some others) that it is their responsibility to govern more or less alone through executive means. The Reagan administration developed this perspective into a fine art form. Statutes often were seen as constraints to be maneuvered around rather than as laws governing executive regulations and behavior. Career officials, experienced with the laws and the meaning they have been given over time, were seen as obstacles.

To make progress on the personnel front probably cannot be done by signaling out HUD alone, and I realize that a more general attack on the problem is outside of the jurisdiction of this subcommittee. Unfortunately, neither problems nor possible ways of dealing with them can always be sliced up in accordance with specific jurisdictional provinces. But I doubt that an advisory commission to deal with HUD nominees gets at the real underlying problem. It cannot, in my estimation, do any more than a careful review of nominees by the Committee on Banking, Housing, and Urban Affairs would accomplish. Since the execution of the laws is of interest to all senators, however, this committee can set an example of careful review of HUD nominees and might well consider restricting the number of discretionary schedule C appointments in the department.

While I realize that my comments are longer on generalities than on the specifics your interrogatory was pointing toward, I hope they can be helpful to the subcommittee.

The views I have expressed here are strictly my own and not to be attributed to The Brookings Institution, its officers or trustees.

Sincerely,

/s/

Bert A. Rockman
Senior Fellow

REBUILDING OF HUD

WEDNESDAY, MAY 16, 1990

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
HUD/MOD REHAB INVESTIGATION SUBCOMMITTEE,
Washington, DC.

The subcommittee met at 10:41 a.m., in Room 562 of the Dirksen Senate Office Building, Senator Bob Graham (chairman of the subcommittee) presiding.

Present: Senators Graham, Riegle, and Mack.

OPENING STATEMENT OF SENATOR GRAHAM

Senator **GRAHAM**. We'll call the meeting to order.

First, we're very appreciative that Secretary Kemp could join us for what will probably be our final hearing of this subcommittee joined by his distinguished colleagues. This is an important part of our hearing process as we summarize what we have learned to date and look to the future as to how we can most effectively apply those lessons.

Tomorrow, May 17, will mark the anniversary of the Senate Banking Committee's first hearing on the reports of fraud, abuse and mismanagement at the Department of Housing and Urban Development.

To date, the Banking Committee has held 6 hearings, and this subcommittee 8, on the scandal and needed management reforms.

This investigation has attempted to focus on the statutory, regulatory, and management practices which have contributed to HUD's difficulties. Our intent has been to root out the systemic flaws in the operation of the agency as a means of preventing similar problems from recurring in the future.

This subcommittee was formed, and on a number of occasions since, we have used the analogy of the rat and the cheese, saying that we were focusing not on the rats, but, rather, on the cheese. We have done more than that. To carry the analogy further, we have also examined the processing and the quality control of the cheese.

During the course of our hearings, we have examined a number of issues, including the capacity of the Department to administer and monitor its programs, the adequacy of HUD's internal controls, the role of the Inspector General in bringing problems to the attention of the leadership of the Department, the White House, and the Congress, and finally, the role of OMB, the Office of Management and Budget, and the Congress, in overseeing the Department's activities.

We are encouraged by improvements made in most of these areas over the last year. We have also learned that there is still much work to be done.

I applaud Secretary Kemp in his efforts to clean up the mess he inherited from the previous administration. However, despite these efforts, HUD still lacks adequate staffing, internal controls, and proper monitoring to assure that future waste, abuse and mismanagement do not recur.

We are concerned about the number of significant weaknesses in HUD's internal control that Secretary Kemp has revealed in his Federal Manager's Financial Integrity Act report.

We are concerned about the damage that has been done to the confidence of the private sector, nonprofits, and State and local governments in their dealings with HUD. We are eager to see whether HUD can soon re-establish itself in a prominent role meeting the housing and community development needs of this nation.

We are pleased to see improvements at OMB in highlighting programs at risk. We remain concerned that the management side of OMB is still incapable of providing executive agencies like HUD with the type of assistance that will prevent a program from becoming at risk in the first place.

We are also pleased that the investigation of HUD on both the House and the Senate side has awakened Congress to the need for effective oversight. It is our hope that through oversight, Congress can help HUD avoid fraud, waste, and mismanagement. We cannot be satisfied if oversight remains just a reaction to the glamour of a scandal.

We look forward to the opportunity to discuss these and other issues with Secretary Kemp today. After this hearing, we will begin the process of reaching conclusions and formulating recommendations for our report.

The ranking member of this committee, who has been a very faithful, constructive and inquisitive member of this subcommittee, and together, we have been learning many of these issues, is my colleague, Senator Mack.

Senator Mack, do you have an opening statement?

Senator **MACK**. Thank you, Senator Graham. I do have an opening statement which I will just ask to be placed in the record.

Senator **GRAHAM**. Without objection.

OPENING STATEMENT OF SENATOR MACK

Senator **MACK**. I am pleased to welcome Secretary Jack Kemp as the last witness for the subcommittee's examination of the problems at the U.S. Department of Housing [HUD]. I look forward to hearing about new developments in his efforts to rectify these problems.

As we began the process of this HUD investigation, we were still in the midst of receiving reports of problems at HUD and Federal housing policy. Through these series of hearings, we have found that a substantial portion of these problems stemmed from a flawed manner of providing housing assistance.

Complicated programs, large pots of discretionary dollars, lack of built-in program protection and coordination procedures and a general absence of statutory foresight to prevent waste, led to a widespread misuse of Federal housing dollars.

We have heard testimony from a variety of different witnesses describing the mechanisms through which people could take advantage of the HUD system. One recurring example was that of "layering" where developers would receive Federal assistance from a variety of housing programs, grossly overcharging the Federal Government for their services.

Significantly, during this subcommittee's process of examining specific problems, many of these matters were resolved by Secretary Kemp. One example is the coinsurance program, which, as I have stated before, was poorly designed and resulted in 100 percent Federal risk with virtually no Federal oversight role. Secretary Kemp terminated this program and has pledged to find another method of providing the services originally intended under the coinsurance program.

Secretary Kemp's bold steps to correct misuse of Federal housing assistance are reflective of his new vision for a more effective housing policy. I am especially pleased with the Secretary's implementation of housing policy, because it is completely consistent with my own philosophy of more freedom and more opportunity for everyone.

My philosophy of more freedom and more opportunity for everyone translates into a housing policy of building "communities" with less crime, less poverty, less drugs and more opportunity. This philosophy could be implemented by focusing our policy on people, not simply "units" of housing. As we have become preoccupied with "units" in the past, we have found ourselves often channeling dollars to developers and others that service the poor. And, as a result, we have created "projects", many times filled with crime, poverty and drugs.

Although past methods may have a role to play in housing policy, the potential it creates of misdirecting housing dollars to middlemen, rather than the poor, ought to be examined. That's why I agree with the Secretary's vision of tenant empowerment. Not only would these policies prevent misuse, they would ultimately encourage recipients of low-income housing to become self-sufficient and gain a higher sense of self-esteem.

And I want to make just a few comments.

First of all, I want to compliment you on the thrust of these hearings. It would have been very easy to go after the personalities involved. But, rather, what we have done is really to try to look at what policies, what programs in the past have, in essence, created these problems. And I think that that was exactly the approach that we should take. And so, I compliment you on that.

And since I'm in the complimenting mood, I can't help but take this opportunity to compliment Secretary Kemp and his team for what you have done, not only in the perception throughout our nation about hope and opportunity for people, but in the realities of the changes and the commitments that you have made at HUD.

If there was one message that I think we heard over and over again throughout our hearings, it was an understanding that there is in fact a new commitment at HUD, that the Secretary and his team not only are interested in seeing that the home opportunities and housing opportunities are available to all Americans, but they're committed to the development of new ideas and new concepts. And I think that that needs to be underscored over and over and over again, because not only is there new morale, as I sense it, at HUD, but there is a new optimism in this country.

I see it in the communities that I visit in Florida, whether that's in Overtown, whether that's in Liberty Square, whether that's in Jacksonville or Pensacola, or many other communities. The message has gotten out that there is a new approach and there's new opportunity. And I think that that's exactly what needed to be done.

So I just wanted to take this opportunity this morning to compliment you on that effort. And, again, one additional point.

One of the other changes that I sense that has taken place is that we are moving away from our focus on bricks, mortar and buildings, and we're focusing on the ideas of the need to build communities, that we need to focus our attention to people, that we need to come up with ideas that help families. And if we are successful in doing those, not only will those individuals be better off, but our nation will be as well.

And, again, I compliment you so much on what you have been up to.

Secretary **Kemp**. Thank you.

Senator **Graham**. We are joined by the Chairman of the Banking, Housing, and Urban Affairs Committee, Senator Riegle.

OPENING STATEMENT OF SENATOR RIEGLE

Senator **Riegle**. Thank you very much, Senator Graham. Let me just say two or three points in observation.

Establishing this special subcommittee that you have so ably led through this work, Senator Graham, assisted by Senator Mack, and a very capable staff, has been an unusual procedure. We had to make a decision as a committee some months ago as to how we would undertake to examine in a comprehensive way what had gone wrong and why there was the opportunity for the fraud, the opportunity for the misuse of funds, all of which had the effect of cheating people out of housing, those in our society who most need the housing.

I think the work that has been done by the two of you, the Florida team here, has been really exceptional. And I want to express my deep appreciation as Chairman, and the appreciation of the committee as a whole, for the work that you have done, together with your staff members, to carefully and systematically work through a program review as to what went wrong, what were the ways and what were the structural failures, apart from the personalities, which is an important component of the story. But the focus of your effort was to get to the issue as to how these programs themselves were susceptible to this kind of abuse. And how was it particularly that programs could be layered one on the other so that a very substantial windfall benefit could accrue to those who cleverly could manipulate these programs, and often with inside help.

So, I think that the work that you have done has been a model of the kind of careful and systematic investigative reconstruction that's needed so that we can decide how these programs are to be changed.

And I want to say, Secretary Kemp, for his part, I think has also brought a fresh energy and viewpoint to these issues as well in the Department. It's not easy to take over a department that has been honeycombed with difficulty, as we have seen in cases under the review of this special subcommittee.

But I think your desire for reform, Mr. Secretary, is as strong as that that we have. So we're now poised to complete the work on the housing bill that we've been developing in the full committee.

I want to say that the work that this subcommittee has done I think is essential to deciding exactly how we want to structure the housing program for the future. We have that opportunity.

Now, we've got to have a housing program enacted in order to be able to implement the reforms and the changes in mechanism and structure. I think we're well down the track on that. We reported a housing bill out with a good, strong vote, and I think we're poised to work with the administration, work with the Secretary, to develop a housing bill and come down the track and incorporate and embed in that housing bill a number of these reforms.

Some have already been put into place. Late last year, we worked together on that, the executive branch and the legislative branch cooperatively. But now, I think we're ready for phase 2, and that is to take the important work of this subcommittee and apply those lessons and those insights in the restructuring of the program that we're about to hopefully enact this year.

So, with that, I want to say how grateful I am for the hard work that's been done here.

Just finally, on the issue of how we're going to get this job done, and I agree with the sentiments that I just heard Senator Mack express with respect to the fact that there is something of a new spirit I think in the country as to how we try to think in a more comprehensive way about communities.

But I would hope that we would never lose sight of the brick and mortar aspect of this thing, because we've got hundreds of thousands of people in this country that are living in cardboard boxes and living under bridges and living on hot air grates.

In this city, there are a lot of hot air grates, as we all know, because the heating system between the Federal buildings runs under the sidewalks. So we have a lot of hot air vents. And there are no vacancies. People are lined up in the cold weather to get on the hot air grates because there isn't enough housing. Not just here in Washington, but in almost every major urban center in the country.

Our shelters are literally overwhelmed by the number of people, particularly in the cold weather, who are trying to get in to have a roof over their heads.

So we've got to do both things. We've got to make sure that there are enough decent and safe living spaces and apartments and homes and settings in which people can live each day and each night, at the same time that we make sure that the program abuses and potentials for abuse are dealt with as directly as we're able to do it.

So, having said that, Senator Graham, I'm very appreciative of the effort that you have made, your special leadership. I think it's a great service to the Senate. I think it's a great service to the country, and I thank you for it.

Senator **Graham**. Thank you, Mr. Chairman, and thank you, Senator Mack.

Secretary Kemp, we are very appreciative of your presentation today and look forward to your remarks.

Secretary Kemp.

STATEMENT OF JACK KEMP, SECRETARY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, ACCOMPANIED BY ALFRED A. DELLIBOVI, UNDER SECRETARY, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT; AND FRANK KEATING, GENERAL COUNSEL

Secretary **Kemp**. Thank you.

First, Mr. Chairman, thank you for the opportunity to testify and the kind remarks that you have made about our efforts. I think the cooperation of the Congress has been just of inestimable value in helping us get on with the task alluded to by each of you in your opening statements.

We have a President who is absolutely committed to type of reform that would be expected of us in this troubled agency, but a President who has zero tolerance for unethical and the type of political behavior that would have turned HUD in the future into what it was in the past—an arm of a political party.

So I'm appreciative of the support that I have had from you, Mr. Chairman, your colleague in the Republican Party, Mr. Mack, who has been a long-time friend of mine. And your State has been, I think, the beneficiary of some of our new ideas, from Operation Bootstrap to the urban homesteading idea. And again, my thanks to Chairman Riegle. Having visited Michigan with him, he knows firsthand my willingness to make HUD a good partner with the governors, with the cities, with the Congress, with the ultimate client in mind, the people who need desperately our helping hand.

So for what you have said, for what you have provided in terms of an opportunity for me to testify about the reforms of HUD and the mission of HUD, I am very grateful. And I also want to pay tribute to Tom Lantos and his committee in the House for the fine work that they have done. And I think a lot of good is going to come out of these hearings. I have approached it on that basis—that this will turn out to be a blessing in disguise.

Someone thought that I meant that it was going to be a political blessing. I meant it's going to be a blessing to the people, to the communities in low income areas and pockets of poverty, from urban to rural America, in which people are hurting.

It's no secret that I believe that we've had a good macro-recovery over the past 6 or 7 years. But, unfortunately, as Connie Mack pointed out earlier, it had not yet touched the lives of a lot of people who had been left out, left behind.

So we've tried to turn HUD into an agency that can help wage war on those conditions of despair and despondency and hopelessness that often lead to some of the social and economic pathologies that have manifested themselves in incredible costs to society and the loss of the physical and human talent that's out there.

So I approach my job, Mr. Chairman, with a desire not only to be a good partner with the Congress, as President Bush wants us to be, but ultimately, keeping our eye on what's in the best interest of people and giving them that hope and opportunity that is central to the American dream, which is not, we have learned in the last couple of years, just an American dream.

It's pretty much a universal dream, indeed.

I compliment you and your staff for the objective, thoughtful, positive, progressive way in which you have gone through HUD's problems with an eye on lasting reform, systemic reform, and political reform.

One comment before I get a little more formal.

I want to just assure you that there is no room at HUD for fraud, waste, mismanagement, unaccountability. There is absolutely zero tolerance by me, President Bush, and throughout my whole team, Frank Keating, my general counsel on my right, Al DelliBovi, the Under Secretary of HUD, on my left.

And I can assure you that we have the staff to do the job. We're asking for staff. We're asking for more money for monitoring our programs. And we acknowledge an ongoing need, as you alluded to in your opening comments, Senator Graham. But I want you to know, there just is no room for any fraud, waste, or mismanagement.

I was absolutely appalled, disgusted, shocked and, if I were in a football locker room, I would use a lot stronger language, to convey my disgust with Dubois Guilliam when he told the House Government Operations Committee that you'd better watch HUD because it's an election year.

I mean, for him to sit in moral judgment on HUD almost defies description, having taken $100,000 in payoffs and bribes, having gone to jail as a convicted felon, sitting before a House subcommittee of the U.S. Congress and telling them, keep your eye on HUD.

I mean, that—well, I'll save my strong message to follow.

This is not a political agency. I can honestly say to you and Don Riegle and Connie Mack, as I have told the President and his team, the election year will make absolutely no difference. In fact, we'll be even more careful. In fact, we're getting accused of being too cautious.

I reject that. I want people to be prudent. But I don't want to remove the mission from HUD. But you have my pledge, as members of the Democratic Party, as I've told members of my own party that calls to Kemp mean absolutely nothing unless they're based on merit, need, criteria, objectivity, competition, and the reforms that Al, Frank and I and all of my team have helped put, with your support, into HUD.

So we are not an arm of the Republican National Committee and if I have my way, and if your party ever recaptures the White House in our lifetime—[laughter]—It is not to be an arm of the Republican Party or the Democratic National Party, two great parties. It is to fulfill the mission, again, alluded to in the opening comments of all of you and my many good friends in both parties in the House.

When I got to HUD, I was absolutely alarmed at the depth of my discovery that HUD, from the structure of its programs to the management of its resources, throughout the length and breadth of the political appointees in the main—let me parenthetically say the career people at HUD have performed not only admirably, but under conditions of duress and stress, and I applaud them publicly. I've done it privately. And I believe their morale has been restored to a large degree.

The other day at our secretarial awards ceremony, I asked how many people have been there since the beginning of HUD, because this is the 25th anniversary. And you'd be surprised how many people have been there for 25 years.

There's a tremendous sense that we're back on track. They need to be treated with dignity and the type of respect to which they are entitled.

But the programs are intended to serve people in need. We're oftentimes lining the pockets of greedy developers, consultants, lawyers and influence-peddlers who had fed on the Department which had proven to be a fertile ground for that waste and fraud and favoritism that has been so highlighted by this committee and Lantos's committee and the press's reporting.

And I want to compliment even the press for their outstanding job of undertaking this uncovering of problems.

I want to applaud, Chairman Graham, HUD's IG, Paul Adams and his team.

HUD inspectors in the past had suffered at best from a kind of benign neglect, as IG report after IG report after IG report outlining the deficiency, mounted one upon the other, year after year, in program after program, and no one listened or took any action.

GAO had studied HUD's programs. As an example, our single family housing program had revealed to GAO that loan origination processing, which was nobly intended to assist first time homebuyers, was indeed rift with abuse. Poorly-qualified appraisers, coupled with insufficient monitoring, grossly inflated property values and the ultimate cost to the taxpayers of America.

At the same time, HUD's single family property disposition program routinely allowed millions of tax dollars to go to unwatched, unclaimed, and even unreturned to the U.S. Treasury.

Clearly, the department's multifamily programs weren't working any better. Developers were seeking profits. Many owners cared little about the physical condition of their property, and even less about the tenants.

Talk about a scandal. Come with me out to Tyler House. Come with me to Tulsa, Oklahoma, where Mr. Keating and I visited recently to see people living in a condition that was nobly intended to improve their aspirations and hopes and living environment, but had been turned into a condition, Senator Graham, that we would not expect of our enemies, much less these precious assets and precious people and precious children who are living in conditions, as I said, that would just tear your heart out. Tear your heart out.

The multifamily coinsurance program—novel in its approach, I'm sure well intended in its goals, proved to be not only systemically and structurally flawed, but administratively unfixable, fundamentally unsound.

A number of undercapitalized and opportunistic lenders, capable of committing the Federal Government to approximately 80 percent of the ultimate insurance burden, often inflated the mortgage amounts, uncoupled the risks from rate of return, and issued loans which clearly could not be supported by projected income streams.

Ultimately, we inherited at the Department of HUD some incredible systemic failures in our internal controls and management systems, the discretionary funding accounts, section 8 subsidy payments, public housing modernization, multifamily loan servicing, asset management, and serious defects in the range of HUD programs, from title I property improvement to the retirement service centers that have recently captured the attention once again of the press, notwithstanding the fact that I abolished or suspended the program almost a year ago.

These well-documented problems represented but the tip of the iceberg. Indeed, HUD's last semi-annual management report to Congress revealed nearly 200 audits and more than 1,000 IG recommendations, many a testament to the failed program policy and management approach of the past.

Mr. Chairman, I recognized early that the road to recovery for HUD would be not a sprint, but a marathon. It would be a long road, one that I was willing to stay on and to stick with. To fulfill our promises to President Bush, you, the Congress, the American people, and the people who needed our help, I could ill-afford to allow any frustration with the problem, although it surfaces oftentimes, to impede our present-day demands for action.

Teddy Roosevelt once said, do what you can with what you have where you are.

I believe we have done in the last year-and-a-half, despite these efforts to reform and restructure and bring about a renaissance, a rebirth, if you will, of our mission at HUD, I am pleased to report to your subcommittee that we have moved actively, aggressively, and very positively to do all that we can within our regulatory, administrative, and legislative powers to turn around the direction of the department, move forward and onward towards the mission, and to restructure HUD with an eye on providing that opportunity for housing and home ownership and economic mobility that is at the center of that American dream.

We terminated and suspended wasteful and ineffective programs. Some people thought that we were following a scorched earth policy, Mr. Chairman.

We have not. We have carefully scrutinized, carefully excised those cancerous cells that were eating into the heart of people's confidence in HUD and our ability to fulfill this mission.

We ordered internal studies, established management task forces to review the widest range of our policies and programs to ensure that HUD meets its responsibilities to deliver both efficient service and cost effective management.

We requested additional funding to correct the mindless practice of maintaining, believe it or not, 77 separate information systems, few of which were compatible.

It's hard to believe. There was no compatibility between the information systems.

We want to make absolutely sure that we possess the analytical, objective, and empirical tools that are requisite for sound management. The Department is conducting now a national search for a chief financial officer and comptrollers at every single spending program or aspect of HUD.

Just last week, Eleanor Clark, an outstanding certified public accountant, joined our HUD team as the comptroller for FHA. And we're in the process of, as I said, widely advertising for five more comptrollers and a chief financial officer. And you have my pledge, Mr. Chairman, to make it a career position, so that when I leave HUD at the end of my stewardship of this agency, you can feel as confident about the future as I hope you feel about the effort we're making in the present.

We've made substantial progress on the enormous backlog of open-audit recommendations we inherited when I came to HUD. Management decisions were made on 95 percent of all audits in the pipeline on October 1, 1989. In fact, final action was taken on nearly half of the audits within the Department's workload since October.

Under the Bush administration, we have realized record progress to resolve a number of significant audits, 65 reports, compared to only 51 over the previous 6 years of HUD's history.

On section 8 expiring contracts the Bush administration and I have been personally, as I know the Congress would want us to be, fully committed to correcting the long-standing deficiencies in the data systems, and in the estimating procedures which previously led to an under-estimate. And most importantly, Mr. Chairman, threatened to make low-income residents and tenants a victim of the bureaucracy. The frustration that had been introduced into their lives was almost causing people to lose faith not just in HUD, but in the whole system.

We expect that the Department's overall program for reforming accounting and financial management procedures will accelerate the improvement of data gathering and budgeting. And equally important, Mr. Chairman, I've worked to change not just the policies and programs, but the attitude and the environment.

I won't delve into it in my written testimony, Mr. Chairman, but you can be assured that the Department has to focus on both the end product and the staff necessary to fulfill that end product. We are moving rapidly to make the type of requests of the Congress for the proper staffing. But you have my assurance that we're not waiting until the final staff is complemented.

H.R. 1 initiated into law and practice a comprehensive set of ethical, financial, management, and FHA reforms sorely needed to support the effective delivery of HUD services to those people in need.

And you have my commitment to working with you to make sure that FHA is stronger in the 1990's by far than it was in the 1980's, where it got off track.

The most significant contribution, Mr. Chairman, that this subcommittee and the Congress can make to the reform of HUD and the programs for low income people and housing and fighting poverty and bringing hope to the American people is to recognize the most important lesson that we have learned in the past year.

That, noble intentions aside, many times have unintended, counter-productive, and often very expensive consequences to the U.S. taxpayer.

Time after time, in program after program, housing developers, and I have mentioned developers many times, Mr. Chairman. There are some absolutely fantastic, dedicated men and women of integrity who develop housing and real estate in America, and I do not want it said that I have so broadly painted a picture that everyone is wrong, but, unfortunately, all too often, those that dealt with HUD along with their well-connected consultants, saw it as a way of extracting benefits from the Department for construction rehabbing or maintenance of properties, but without any direct benefit to the poor.

We know from past experience, Mr. Chairman, with subsidized housing construction programs, in my view, that at least a third of the benefits all too often go to the developer, the syndicator, the lawyer, instead of the poor people that we should be helping.

I favor the low-income housing tax-credit, but the layering of tax credits with subsidies contributed to financial windfalls and profits to the developer and the owner at the time that the property they owned came to symbolize the absence of any hope to the people that were living in the inner cities.

One lesson, Mr. Chairman, of reform, at least from my standpoint, is that we cannot just throw up our hands and despair over the past failures, then turn around and shift the resources to another level of Government and abrogate our responsibility at the Federal level to develop, maintain, monitor the type of a national housing policy that meets those national objectives and takes into consideration the people themselves as the ultimate object of our noble intentions.

We must, in my view, take a very long and critical look at any proposed housing policy which would effectively just decentralize the failure and then institutionalize it at the local level.

I am a strong supporter of federalism. But I'm not a supporter of the idea of just mindlessly shifting the resource and then institutionalizing the systemic failure at the local level. And I'm not pointing the finger at anybody; I'm just saying that we should learn that there is something inherently flawed in taking Federal dollars and holding them out to someone and expect them not to try to begin to take advantage and predicate their decision on the opportunity for profit at the expense of the mission that we both seek.

That's why we're tightening up the tax credit system the layered subsidy program, tightening up our program monitoring and making sure that we support programs that deliver not only brick and mortar, Don, but also raise the aspirations and the spirits and the hopes and dreams and opportunities for people to move forward and upward in this great country of ours.

So I express some concern about legislative proposals. Let me say that I do not want to give the impression that we are in any way discouraged. We are encouraged, Mr. Chairman. My talks with Chairman Riegle, my talks with Senators Cranston, D'Amato, Garn, the House, Gonzalez, the chairman of the House Banking Committee, Chalmers Wylie, I believe we can have housing legislation. I agree with Don Riegle. That's chapter 2. That's what we should be focusing on, notwithstanding the great work that I believe this committee has done and, of course, has been done over in the House.

The last point and then I'll stop and answer the questions. Thank you for giving me your indulgence, Mr. Chairman, and letting me focus attention on some of the less visible, but equally important, aspects of reform.

One of the most critical reform challenges that we've embarked upon in the past year is restoring in the 1990's the financial health of FHA.

My wife and I bought our first home with FHA in 1960 when I was a young father, a young pro football quarterback. I remember we put $500 down. Had a 30-year fixed-mortgage of 5 percent.

Remember those days, Connie? Are you old enough to remember that?

Had a 30-year fixed mortgage, FHA-insured, 5 percent. $15,000 home—four bedrooms.

It is impossible to afford to buy the home that I bought, my wife and I bought, with an FHA-insured mortgage in 1960.

I couldn't buy it.

What has happened to the American dream to me is the ultimate scandal. You have my pledge to use the good work that you've done, to work with Democrat and Republican alike in the Senate and the House on behalf of this administration to work towards not only making FHA fiscally responsible, but to get it out of the golf course business and back into helping first-time homebuyers, low and moderate income people, and doing what it was set up to do at its genesis.

So I applaud you, Senator Graham. I obviously applaud my old friend and comrade in arms from the House days, Connie Mack. I thank Don Riegle for his incredible efforts to move forward in both of these areas and hope that out of this comes some real good, the good being not anyone's political benefit, but the ultimate benefit of being able to say that in the 1989 revolution, President Bush's words, you and I had an impact, made a difference on behalf of restoring to this country that dream to which all men and women aspire all over the world.

Thank you.

[The complete prepared statement of Secretary Jack Kemp follows:]

STATEMENT OF SECRETARY JACK KEMP
BEFORE THE
HUD/MOD REHAB INVESTIGATION SUBCOMMITTEE
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
MAY 16, 1990

Mr. Chairman, Senator Mack, I appreciate this opportunity to appear before you to discuss the course that I have charted at the Department of Housing and Urban Development to restore fiscal, management, and program integrity at HUD, and to reinvigorate our historic mission to provide housing, economic opportunity, and homeownership to low and moderate income Americans.

When the Senate Banking Committee established this Subcommittee, I discussed with each of you our mutual goal -- and promised my full cooperation -- to strive to ensure that the failures of the past would not only be corrected, but that a high ethical standard be established at HUD and that the systemic deficiencies we discovered would not be repeated in the development of new housing policies and programs.

I want to commend both of you for the sincerity of purpose and fairness in approach that you have demonstrated in the Subcommittee's efforts to explore the many facets of this Department's programs, review the fundamental flaws that have been uncovered, and evaluate the corrective measures that the Bush Administration has implemented to "clear the decks" at HUD.

Mr. Chairman, I also would like to take this opportunity to comment on a statement made at a hearing held by your counterparts in the House. I was absolutely appalled that a former HUD official -- a conivicted felon -- would suggest to a Congressional Committee that Congress had better watch HUD in 1990 because it's an election year. Mr. Chairman, let me state to this Subcommittee, this Congress, and to every single person within earshot, there is no room -- absolutely none -- for politicking and profiteering at HUD.

SCOPE OF THE PROBLEM

Mr. Chairman, Abraham Lincoln, in another place and another time, commented on the troubles of the day by saying "We live in the midst of alarms; anxiety beclouds the future; we expect some new disaster with each newspaper we read." It is no secret that I have often stated that Mr. Lincoln's vision was timeless, but I have rarely felt closer to his words than when I became Secretary of HUD.

Indeed, I was alarmed to discover that the Department of Housing and Urban Development -- from the structure of its programs to the management of its resources -- in a state of almost complete disaster and disarray. Programs intended to serve those in need more often lined the pockets of those with greed as developers, consultants, lawyers, and influence-peddlers fed on a Department that proved to be fertile ground for waste, fraud, and favoritism. A succession of HUD Inspectors General suffered -- at best -- from a kind of benign neglect as IG-reported deficiencies mounted one upon the other, year after year, in one program after another.

GAO studies of HUD's single-family housing program revealed that loan origination processing, nobly intended to assist first-time homebuyers, was instead rife with abuse as poorly qualified appraisers, coupled with insufficient monitoring systems, grossly inflated property values and ultimate costs to the government. At the same time, HUD's single-family property disposition program routinely allowed millions of tax dollars to go unwatched, unclaimed, and unreturned to the Federal Treasury.

Clearly, the Department's multifamily programs weren't working any better. Developers seeking profits and owners who cared little about the physical conditions of their properties -- and even less about the tenants they supposedly served -- diverted project assets and income from project operations in a willful and callous disregard of their regulatory agreements with HUD.

The multifamily coinsurance program, however novel in its approach or well-intentioned in its goals, proved to be structurally flawed, administratively unfixable, and fundamentally unsound. A number of undercapitalized and opportunistic lenders, capable of committing the Federal government to approximately 80 percent of the ultimate insurance burden, often inflated mortgage amounts, uncoupled risk from rate of return, and issued loans which clearly could not be supported by project income.

Ultimately, the Department I inherited bore systemic failures in internal controls and management systems; discretionary funding; Section 8 subsidy payments; public housing modernization; multifamily loan servicing and asset management; and, serious defects in a range of HUD programs from Title I property improvement to Retirement Service Centers.

These well-documented problems represented only the tip of the iceberg. Indeed, HUD's last Semiannual Management Report to Congress revealed nearly 200 audits and more that 1,000 IG recommendations, many a testament to the failed program, policy, and management approach of the past.

MANAGEMENT ACTIONS

Mr. Chairman, I recognized early that the road to recovery at HUD would be a long one, and that to fulfill my promises to President Bush, this Congress, and the American people I could ill afford to allow my frustration with the problems of the past to impede the present-day demands for action. As Teddy Roosevelt once said, "Do what you can, with what you have, where you are."

I am pleased to report to this Subcommittee that as Secretary of HUD I have moved actively and aggressively to do all within my regulatory, administrative, and legislative powers to turn around the misguided direction of this Department, and to move upward and onward towards our mission to help those in need.

The Department has terminated and suspended wasteful and ineffective programs, while intensifying its commitment to serve poor people; I have ordered internal studies and established management task forces to review a wide range of HUD's policies and programs to ensure that HUD will meet its twofold responsibility to efficient service delivery and cost-effective management; we have requested additional funding to correct the mindless practice of maintaining 77 different information systems, few of which were compatible, to make absolutely sure that we possess the analytic tools that are a requisite for sound management; and, the Department is conducting a nationwide search for a Chief Financial Officer and program Comptrollers. I should note, Mr. Chairman, that just last week Eleanor Clark joined the HUD team as Comptroller for FHA.

During the past six months alone, the Department has made substantial progress on the enormous backlog of open audit recommendations we inherited when I came to HUD. Management decisions were made on 95 percent of all audits in the pipeline on October 1, 1989. In fact, final action was taken on nearly half of the audits within the Department's workload since October. Under the Bush Administration, we have realized record progress to resolve a number of significant audits, 65 reports, compared to only 51 over the previous six-year period.

Regarding Section 8 expiring contracts, I have been personally and fully committed to correcting long-standing deficiencies in the data systems and in the estimating procedures which previously led to an underestimate and, more importantly, threatened to make low-income tenants a victim of our own bureaucratic failures. And, we expect that the Department's overall program for reforming accounting and financial management procedures will accelerate the improvement of data gathering and budgeting.

Equally important, I have worked to change not just policies and programs, but attitudes and environment. In today's HUD, my senior management team knows that I hold them fully accountable for effective management, monitoring, and delivery of the programs under their purview, and that a manager's own performance reviews will be directly linked to his or her success in addressing defects within the HUD organization. I am also proud to say that I have established a fully staffed ethics office and fully developed ethics program at the Department -- a first in HUD's history.

Mr. Chairman, I know that the Subcommittee has expressed an interest in HUD's overall staffing and resource capacity. I firmly believe that the Department must first focus on the "end product"; what is it that we are seeking to deliver to low and moderate income Americans, and does the structure of our policies, practices, and programs support those desired ends? While I am fully committed to seeking the resources necessary to support sound programs and policies, I want to make absolutely sure that, first, we have properly and systematically addressed the design, direction, and delivery of the HUD "product".

RELATIONSHIP WITH CONGRESS

Mr. Chairman, in each of this Subcommittee's hearings, you have asked witnesses what Congress can and should do to assist in the oversight and management of HUD programs to improve the relationship between this Department and Congress.

When I testified before the Senate Banking Committee at my confirmation hearing, I indicated that "I want to be a bridge between HUD and this Committee, and between the Federal government and those people who want a better life and a better America for their children."

Mr. Chairman, despite the difficult times that we have endured over the past year and a half, I am pleased to say that the bridge between the Department of Housing and Urban Development and this Congress remains ever-resilient and ever-strong.

At the end of last year, the Senate Banking Committee, the House Banking Committee, the entire Congress, and the Bush Administration worked tirelessly together to pass HR 1, the HUD Reform Act. I am grateful to Chairman Riegle, Senator Garn, and every member of this Committee for the vital role that they played in passing that critical and long-overdue legislation.

HR 1 initiated into law and practice a comprehensive set of ethical, financial, management, and Federal Housing Administration reforms sorely needed to support the effective delivery of HUD services to Americans in need, and I look forward to working with Congress on still greater reforms in HUD programs.

Additionally, my management team and I have testified before Congressional Committees and Subcommittees in numbers unprecedented in recent years; I have met personally and frequently, formally and informally, with dozens of Members of Congress and their staffs; and, most importantly, the doors of HUD have remained open to the ideas, the initiatives, and the interests of Congress.

But the most significant contribution that this Subcommittee and this Congress can make to our reform efforts is to recognize the most important lesson that I have learned in this past year: that our past noble intentions have had unintended, counterproductive, and very expensive consequences. Time after time, in program after program, housing developers or well connected consultants were able to extract huge benefits from the Department for the construction, rehabilitation, or maintenance of properties, with little direct benefit for those in need.

We know from past experience with subsidized housing construction programs that at least one-third of the benefit goes to the developer, the syndicator, and the lawyer, instead of to the poor people we should be helping. And we learned, Mr. Chairman, that the layering of tax and other subsidies contributed to huge financial windfalls for developers or project owners at the same time the properties they owned came to symbolize the very absence of hope in our inner cities.

One lesson of reform, at least from the standpoint of this Secretary, is that we cannot just throw up our hands in despair over the Federal government's past failures, turn around, and shift our resources to some other level of government, and then abrogate the responsibility of the Federal government to develop and to maintain a national housing policy that meets national objectives. We would take a long and critical look at any proposed policy which would effectively decentralize failures and institutionalize them at the local level.

I am, therefore, concerned that legislative proposals contained in housing authorization bills now pending in Congress appear to ignore these important lessons, and invite the same sorts of abuses which over the past year we have worked so hard to address. While the Bush Administration's Homeownership and Opportunity for People Everywhere (HOPE) is not a cure-all -- in addition to its social and economic goals -- it intends to put Federal benefits directly in the hands of those in need.

HOPE is a visionary and comprehensive strategy for empowerment, individual initiative, housing, and homeownership. If enacted, HOPE can make great strides towards breaking the long cycle of government-dependency and placing low-income citizens on the road to self-sufficiency.

And, Mr. Chairman, I believe that the Administration's approach makes better and greater use of all the available, realistic and cost-effective tools at our disposal -- profit and nonprofit, public sector and private, Federal, state, and local government, the tax code, and direct spending -- to increase the supply of affordable housing.

One final point, Mr. Chairman, on reforms. One of the most critical reform challenges that we have embarked upon in the past year is restoring the financial health of the FHA fund. As you know, I firmly believe that the Federal Housing Administration is a cornerstone in our efforts to develop a Federal housing policy which can build a better life for low and moderate income families all across this country. A fiscally responsible review of FHA necessarily requires a comprehensive assessment of the Fund's actuarial soundness, and we are working with the financial accounting firm of Price Waterhouse to assess the current condition of the FHA Fund and to craft solutions to the Fund's problems. Rather than seeking short-term fixes, I want to make absolutely certain that FHA's mutual mortgage fund can sustain itself during good times and bad, through the rest of this decade, and into the 21st century.

I am pleased to report that the Department is nearing completion of this evaluation, and we look forward to discussing with the Congress and the mortgage finance industry our recommendations to accomplish an acceptable and responsible resolution this year.

Mr. Chairman, I am proud of the proper partnership that exists between HUD and this Congress, and I look forward to continuing the dialogue on our mutual interests in fostering and creating a society of opportunity.

Our challenge is not only to reform and restore integrity to HUD programs, a process which will not occur overnight, but to reach out to those who seek their rightful share in the American dream.

As Franklin Roosevelt said, "The test of our progress is not whether we add abundance to those who have much; it is whether we provide enough for those who have too little."

I look forward to working with the Department's many important partners to provide housing and homeownership, entrepreneurship and economic opportunity to those who have too little.

Senator **Graham**. Thank you very much, Mr. Secretary, for a very constructive statement and one that gives to me, and I'm certain the other members of this committee, optimism as to the future direction of national housing policy and the relationship among the various components of governments and particularly, then, with the American people, to restore their basic confidence in the ability and the integrity and the motivation of your department to achieve those goals.

Secretary **Kemp**. Thank you.

Senator **Graham**. I want to say how much you have contributed to this by the restoration of public confidence.

I want to ask a few questions that start from your assessment of the Department in the first days after your arrival.

One of the things that has struck me in looking for motivation for actions, that relatively few of the people, the rats, if we could describe them so inartfully, were motivated primarily by money. That was particularly true of the people who were inside the Department, as opposed to those who were benefiting by the programs from the outside.

Rather, there seemed to be a climate and a culture at HUD that found the type of behavior that was characterized as favoritism, building a relationship for future, nonmonetary benefits, using HUD as a dumping ground for persons whose qualities were more based on their past or potential political contributions, both financial, but particularly otherwise, rather than their real interest in housing programs.

So I guess my question is how did you assess that culture and climate, the moral attitude of the agency when you took office? And to what do you think that climate was attributable?

Secretary **Kemp**. I agree with your assessment of what had happened all too often in the past.

I had the benefit of coming into an administration in which I was given full reign, had all of the authority I needed, not only to pick my own team based upon merit and my own and that of my team's objective analysis of the qualifications. But the essence of President Bush's message to me was, and to all of the Cabinet members, was that ethical conduct and behavior was as noble a purpose of government as carrying out the reforms. The restoration of confidence in Government at all levels, the President said, as well as making sure that service to other people was the measure of success in one's life, I think set a high—I don't want to make it self-righteous—but a high moral and ethical tone for all members of the President's Cabinet.

I'd like to think that we have performed up to his high standards. But I think the most important thing he did for me was tell me, you hire any man or woman of any color, race, ethnic background, that you feel is essential to putting HUD on the right track.

That was helpful.

I have had no one pushed on me by the White House. There have been suggestions, I would be less than candid if I didn't say that, but I can honestly say that every member of my key inner-circle team, the sanctum sanctorum of HUD, are there because of the quality of their character, their intelligence, and their commitment to these goals that we have outlined for HUD.

I think that's had a lot to do, Bob, with whatever success we've had in the year and a half of HUD.

Second, my impression when I got there was that it was troubled, but not as deeply and profoundly and systemically as it was.

I met with Paul Adams and it took literally 2 days just to get through the surface problems that he had been investigating at HUD. He and IG Inspector Dempsey, Charles Dempsey before him, are both outstanding public servants. And I'm glad to see that they've gotten the type of recognition that they deserve because they are a creature of the Congress and they've been fully supported by this administration. And by the time we had finished with our briefings, Bob, it was obvious to every one of us that it would take a Herculean effort to clean out the stables, so to speak, without any rivers to divert, and to do it with our bare hands.

I don't want to sound self-serving because it wasn't me. It was really the type of spirit that Frank, Al and my whole team brought with us.

We're still undergoing it, but it is far deeper than anything I could have imagined when I took it. But I do not look upon it as insurmountable. I come at this with a sense that, within the problem are the seeds of a solution. We've let the chips fall where they may. I've taken some real criticism in my own party for failing to blame it all on Jimmy Carter. Or going back even further.

I think that would be unseemly. I think it would be dishonest. I think it would not be credible.

There are some systemic problems. FHA's commissioner under Dwight Eisenhower had to resign under a cloud. But he had been appointed in the Truman administration.

The problems in FHA have gone back to Harry Truman. And I'm not attacking Harry Truman. I'm a Truman fan and an Eisenhower fan. But I'm just saying, some of these problems had gone back decades.

But I thought if I were to do the job, given the nature of the problem that you were investigating or looking into and looking for answers, I wouldn't have any credibility with you or the President or the American taxpayer or the people had I not let the chips fall where they may. And frankly, in the last 8 years, the problems were practiced to a degree unparalleled.

Senator **Graham**. Well, that's the real—I'm asking you to be a diagnostician in drawing upon the unique perspective that you had beginning in late January 1989.

What was your assessment of the pathology within that Department? Why had this Department, unique certainly in degree, if not in character to what had happened in other executive agencies, fallen into such a cultural swamp?

Secretary **Kemp**. Well, the nature of the political appointees, I alluded to the fact that I thought the career people at HUD were 99-9/10ths percent part of the solution, not the problem.

There were systemic problems, programs that allowed for huge profit-making and influence-peddling and political pandering.

I don't think I could characterize it in just one sentence because there were both people problems and systemic problems.

The programs were flawed. No one had ever looked at them before other than the IG and GAO. And that's why I've been so encouraged by what you and Tom Lantos and other members of Congress are doing. I think it's given us a sense that people are really willing to turn this burden into a blessing and take a look at, as you have done, Mr. Chairman, not only the political problems of the past, but where were the program faults, where were the systemic poisons, where were the counter-intuitive policies that had led to windfall profits and political influence at the expense of low income people.

That's why I'm very careful about going into housing legislation in 1990. No one wants it more than I. But I don't want to do it and allow these problems to manifest themselves in the future, maybe not at the Federal level, but at the city level or at the State level.

I'm not making light of mayors and governors and I'm not accusing anybody of anything. But it would be a terrible mistake to institutionalize the problems we've seen in the past by just block-granting them all back to the States to let that problem reflect itself in a poisonous way.

Senator **GRAHAM**. We do not have the lighting system operative in this room, so we're going to have to exercise our own form of self-discipline in relaying the questioning.

I think that I have used more than my 5 minutes. Senator Mack?

Senator **MACK**. Thank you, Mr. Chairman.

Jack, I think that, for me, looking at this issue about what happened in the past and the corrections that have been made, that the significant question is can you, can we be comfortable that at the day you decide to leave, or your team leaves, that there is in fact in place, as you would say, a systemic approach to making sure that the problems that we experienced in these last 8 years don't happen again?

Secretary **KEMP**. We have——

Senator **MACK**. And let me just—I guess a word of background. The reason that I raise that is because, in a number of our hearings, it was mentioned over and over again the importance of management, and the focus pretty much that the individual—that is, the Secretary—really sets the tone, really makes the determination.

So I guess what concerns me is that we could go through a period of many years, new secretaries. What happens in the trenches to make sure that we don't get ourselves back into trouble?

Secretary **KEMP**. Yes. Well, everything we've done in H.R. 1, the reform of HUD, is being put out in regulation, in handbooks, in the training, in the attitude, in the spirit through the length and breadth of HUD.

Second, we are going through the report on material weaknesses with such an effort, I think unmatched, if I may say so, not on my own behalf, but on behalf of my team, in a way that I don't think has ever been paralleled.

Let me put it that way.

Third, the type of financial management systems that are being implemented at HUD, Connie, those will last because they'll be careered. We'll have a chief financial officer, comptrollers in every division at HUD with any responsibility in the expenditure of public monies.

There will be certified public accountants, distinguished men and women from the big 8 accounting firms who will be careered at HUD, along with the CFO.

Our reforms, in ethics, management and finance, and at FHA, I would be happy to submit for the record that go beyond I believe anything that's been done in housing and HUD in the history of the agency.

I want to be very careful and say, as a postscript to that comment, that, ultimately, the mission of an agency depends upon its people.

So I can't answer that once and for all time we have cured—I'm not utopian. People can take advantage of programs. But in abolishing the Secretary's discretionary account, I hope some future Secretary doesn't try to get Congress to give it back to him or her.

It's too tempting, if you will.

And then, finally, I've got a lot of people on the left and on the right who want us to abolish HUD and turn it into a giant voucher program. I reject that idea. There is much more of HUD as an antiproverty agency than just taking every program and turning it into a voucher or a certificate.

I have high regard for voucherizing and using choice and empowerment of families as a way of advancing the goals of helping people directly, as opposed to subsidizing developers. I do. I respect that. I support it. We're asking for more.

I want to measure the success not by how many people need the voucher, but by how many people could use the voucher as you and I have talked, and Bob Graham and I have talked in Overtown, using the voucher for temporary assistance until they get their feet on the ladder and can move two or three rungs up that ladder, and then that voucher or incremental unit can be used for someone else.

That could be the measure of our success, not how long people are on vouchers or how long people are in public housing.

When I got to HUD, we were giving awards to people who had lived in public housing the longest. I cancelled them. The purpose of welfare is not to measure the success of government assistance by how long people need it, but by how quickly people can move through the phase of their life in which they need some boots with which to pick themselves up by.

In fact, and I'll stop with this, we issued a national declaration of independence for public housing residents in Dallas two or three Fridays ago. We want to create a million new private homeowners by 1992, using homesteading vouchers, the value of which could be monetized to give people in HUD-assisted housing a chance to buy out developers in this issue of preservation and FHA.

A combination of those three tools, I believe, would give us a million new homeowners in the ranks of low and moderate income Americans who never had the chance before by 1992, with the cooperation, obviously, of the type of members of Congress who support homeownership, notwithstanding the need to help renters.

Senator **Graham**. Mr. Secretary, you commented about the interplay between clarity of mission and the capacity to carry out that mission.

In our system, it is the responsibility of the legislative branch to enact law and policy subject to either the signing of that by the chief executive or the override of a veto by the Congress. And then it's the responsibility of the executive to carry out those programs.

Secretary **Kemp**. Right.

Senator **Graham**. Could you comment as to your sense of how clear congressional statement of mission and intent has been? And if it has lacked clarity, what would you suggest could be done to enhance it? And what have been the consequences of that lack of clarity?

Secretary **Kemp**. Well, let me try and answer, and if I'm missing the premise of your question, please interrupt me because I'm not sure I totally understand.

I think Congress, Senator, has not done a good enough job, and I say that generically, not looking at anybody specifically. But I don't think Congress has done a good enough job until more recently in its oversight responsibilities. I think that's fair to say. Chuck Dempsey said that, the IG that was there before Paul Adams. And I think Paul Adams, in his heart of hearts, would say the same thing.

But I think there's been a significant change—there has been a sea change in the attitude of Congress. But it wasn't exercised as well.

There was too much willingness, as you put it, to allow the Secretary to have discretion, to make waivers of rules and regulations that had been published for good reasons. I favor a waiver, but it ought to be published in the Federal Register. They'd never been published before. They were being done in the dark, in a back room, in secret.

I think that was our mistake in Congress. Go ahead. I'm sorry.

Senator **Graham**. Yes. You solicited further sharpening of my question.

Secretary **Kemp**. Right.

Senator **Graham**. I'm looking at Congress as architect.

Secretary **Kemp**. OK.

Senator **Graham**. It's our job to present a set of shop drawings which have passed the political process, that then an executive agency can take those, understand what was it that was intended to be accomplished, and the tools that have been provided to achieve that task, and go about. And then, at the end of the process, be subject to the accountants coming in and looking at the books to see whether the architect's goal was accomplished.

Secretary **Kemp**. Right. Well, this is a fascinating question because it goes to the heart of my dialogue with Senator Riegle over legislation for the 1990's on housing.

We should be very careful about getting into programs that would either parallel the problems of the past or institutionalize those problems, only do them at the State and local level.

That is a warning from Kemp. That is not to diminish in any way my enthusiasm for working with everybody on legislation in housing.

But, for instance, I think you—I mean you, generically, Congress—asked, and I was there, too, I think we asked too much of HUD. We wanted FHA to insure hospitals in Chicago and in New York and in Miami. We asked HUD to develop real estate. We got into the AD&C loan business. We got into the title X land development program that built golf courses.

I wouldn't be surprised if someone, and this is not a warning, but I wouldn't be surprised if some of our programs didn't reflect some of the problems that the S&L's had in real estate.

Congress asked FHA to get into vacation home loans. Why, for goodness sake, should FHA be involved in vacation homes?

The dealer origination of home improvement loans. With all due respect to home improvement, that's not what FHA was set up for. Private investor loans. Coinsurance.

We're going to issue regulations to have FHA in full insurance where it can be tightly monitored and controlled and regulated and take the flaws in the old coinsurance program—not old. It was only since 1983.

I guess I could go on and on. Do you want me to——

Senator GRAHAM. Well, you're suggesting that, one, is that, looking at the macro level, that HUD has a more limited set of objectives——

Secretary KEMP. And do them better.

Senator GRAHAM [continuing]. Than it has been charged with carrying out.

Secretary KEMP. Yes.

Senator GRAHAM. Have you been asked to do things that are outside your legitimate range of responsibility? Is that correct?

Secretary KEMP. I believe that. I think Congress asked HUD to do too much. I think it would be better to tighten its mission and do it well than to broaden it to a point where it is asked to get into the type of risky business that not only causes frustration to you and to the taxpayer, but it hurts the clients because FHA was compromised. I'm using FHA because we're about ready to come out with a report from Price Waterhouse that will give us a picture of the financial condition of FHA in the 1990's

It's going to be better than some of its critics thought. It is not going to be as good as you and I want it for the 1990's. And I pledge to work with you, and this administration is fully committed to making FHA in the 1990's what it should have been in the 1980's, and we want in the next century.

But they were doing things that compromised it morally, ethically, financially, and in every other way.

So that's just an example, Bob, of I think what would answer in part your question.

Senator GRAHAM. My time is up. I would like to ask one final question in this area, and that is, assuming that a program is clearly within the ambit of HUD responsibilities.

Secretary KEMP. Right.

Senator GRAHAM. We come back to the question of clarity of what that specific program's goals and missions are to be. And you criticized that one of the problems with the Department has been the absence of that clarity, and therefore, the degree of discretion which ambiguity permits.

Do you have any suggestions as to how Congress and the Department can work together more effectively within those areas that we would all agree are appropriate for the Department in achieving its mission of providing housing for American families, particularly those of moderate and low income, so that there was not a repetition of this lack of understood mission?

Secretary **Kemp**. Right. I have told the Congress and the relevant committees dealing with housing legislation for the 1990's, that I would be willing on behalf of the Bush administration to be flexible on money, flexible with regard to the budget, flexible with regard to the funding of the program, if they, indeed, would be equally flexible on the analysis of the programs of the past and how we want to design them for the future.

In other words, we would be far more willing to exercise our flexibility on funding—that means coming up some, even though it's so-called tight budget constraints—in exchange for the willingness of the Congress to work with us to make sure that we don't design a housing program that encompasses some of the flaws which I've addressed in my testimony. And which should be obvious to everybody.

I think that would be very helpful. Be very careful and prudent, that in our rush to get into the Rose Garden for a signing ceremony on housing legislation, maybe in the fall of 1990, inasmuch as I want that and everybody here wants that, as does the President, that we not trip over ourselves just to continue business as usual.

We want to be open for business, but not business as usual. I think we should be very careful. Now is the time to be very prudent. And I think what the committee has done is absolutely essential, Bob, in making sure that we don't institutionalize at the State and local level what had become institutionalized profiteering and pandering and politicizing of HUD in the past.

Senator **Graham**. My time is up. I'd like to ask if maybe you could supplement your testimony——

Secretary **Kemp**. I'd be happy to.

Senator **Graham** [continuing]. With some programs that you think first fall outside of the legitimate mission of HUD.

Secretary **Kemp**. Well, I mentioned some for FHA.

Senator **Graham**. Yes. If you would like to add to that list.

Secretary **Kemp**. OK.

Senator **Graham**. And second, any specific comments on the legislation which was recently reported by this committee in terms of how it meets your standards of clarity of transmitting, communicating what those programs or altered old programs intended to accomplish.

Secretary **Kemp**. OK.

Senator **Graham**. Senator Mack.

Senator **Mack**. Thank you.

Jack, I want to go back to the question that I raised earlier, which, again, I'm looking at this really in the context of control, the idea of what we need to do to make sure these problems don't develop in the future.

And, again, I build on your comment that most of the problems that developed in the last 8 years, or in that 8-year period, came from the political side, the political appointees, as opposed to the career personnel.

Secretary **Kemp**. I was just asking Under Secretary DelliBovi, if we could think of any career people——

Senator **Mack**. OK. I'm not questioning. I'm just going on the premise because the premise also includes Secretary Pierce.

And what I'm saying is that we can put into place all of the things that you all have done and end up with an individual like Mr. Pierce years from now and find a replay.

So what I'm trying to find out, is there something that we in the Congress should have done? I'm wondering during your discussions of trying to come up with solutions, somebody just didn't say, I wonder why the Congress didn't do this, or it didn't do that.

Secretary **Kemp**. Right.

Senator **Mack**. They could have played a more helpful role in this respect.

Secretary **Kemp**. Yes, they could have.

Senator **Mack**. So I would be interested in what your comment is.

Secretary **Kemp**. Well, the first thing is to follow the recommendations of the IG. The stack of recommendations by the Inspectors General, from Dempsey to Adams, would reach to the ceiling. Well, that's an exaggeration. But in terms of the work it would take, it would reach to the ceiling.

They were not followed up either by HUD or by the Congress. Look, I don't want to just sit here in judgment of the Congress, but I do think the question that you have asked, and also Chairman Graham, should remind us all that Congress has an oversight capability and responsibility that was not carried out to the degree that it should have been.

HUD was at fault. The administration was at fault. There's enough fault to go around in this. I appreciate the fact that you're focusing on the future, as opposed to just the past. But the past is a legacy that will not go away unless we assure that it won't happen in the future.

I can tell you, Connie, Senator Mack, that I am convinced that the systemic reforms in ethical behavior, in management of HUD, hopefully in the programs to come, and what we've done in abandoning clearly flawed programs in the past, moving towards directly empowering people, as opposed to empowering the bureaucracy or empowering the poverty layer, the people who have a financial interest in poverty.

We should be empowering people, not the poverty bureaucracy, or the developers.

So I think if we're careful right now, we can move forward. We should be very careful of this legislation.

One other point I want to make briefly. Briefly. I do not want to underestimate the necessity of highlighting for you and the Chairman and those who may be watching in or listening—hopefully, the Congress will analyze this testimony as well—the necessity of publishing in sunshine every decision, all of the criteria for every decision, all of the competitive process through which that decision had to go, so that we don't go back to backroom politics for doing business with HUD.

We are now publishing all of our decisions in the Federal Register. I tell members of Congress who call me on the phone, all right, call me and give me the data that supports your position, but be prepared, not because I would do it, but be prepared for a FOIA—a Freedom of Information Act request—because it's going to be on the front page of your morning newspaper, or the Post or the New York Times or the Wall Street Journal. And all of the good investigatory reporters who've been involved in this.

It's going to be out.

So make your request. Don't call me unless you're calling on behalf of a meritorious project. In your mind, you have a right to call me. Or call my staff. But be prepared. It's going to be published in the Federal Register and I don't have any influence over the decision. I don't have any.

It's not because I am trying to be morally self-righteous. It is because I think it is unethical to ask the Secretary of HUD to intervene on behalf of a waiver or a decision because somebody's got more clout or is a Republican or is a Democrat chairman or—that type of thing.

So it's all going to be published. It's all going to be based on merit, need, competition.

In fact, we did it so well in 1989, we really left some cities out of the funding for the antidrug elimination program grants that we have had to go back and redesign and work with cities and PHA's and others who are involved in this process because it was not actually meeting the need.

So I admit that we needed to do a better job of designing our competitive process and our criteria. And that's an ongoing challenge to all of us. But I think together, we can make the system work. And you can be assured that I'm not going to sit in the back room and allow any of my people to make decisions over special projects in their district.

That wink was not meant to——

Senator MACK. Yes, who was that for?

Secretary KEMP. The wink was about special projects. I was a congressman. I'm a man of the House. I love the House and Senate and love this institution. But I just want everybody to be on notice that if they or their staff call anybody from Tim Coyle, my assistant secretary for legislative affairs, to myself, or DelliBovi or Mary Burnette or any of my team, or Austin Fitts, our housing commissioner—they're afraid to call Keating. He's too tough a lawyer.

But any call to me had better be based on merit and need and the competitive process and it will all be published in the Federal Register some day. Or as soon as we can.

Senator MACK. Let me just touch on another aspect of that question, which had to do with, again, the political appointees.

Jack, I want to focus on the part of that question that has to do with the political appointees because it could be drawn that if most of the problems occurred as a result of decisions made by political appointees, that the Congress really didn't do a good enough job in screening people appointed either by the President or by the Secretary himself.

So I'm raising the question about—you know, we get into this debate of it's the President's right or the Secretary's right to appoint his own team. Most of the time, the people who are in fact nominated do get confirmed.

Secretary **Kemp**. Good question. That's a great question.

Senator **Mack**. OK.

Secretary **Kemp**. That's a great question because it goes to the heart of our democratic system.

Maybe somebody in Poland is watching this or maybe somebody in the Diet in Japan. Or maybe somebody in Nicaragua who's trying to set up a new democracy in the Chamorro regime may be watching.

I must say, with all of the enthusiasm and sincerity that I can convey to you and to our Chairman, Bob Graham, I believe in political accountability. I believe that it's essential to have the President and the House and Senate elected 2, 4 and 6 years. I think political appointees must be held accountable.

The lesson is not to abolish the political system; it is to make sure that the programs are not at fault, too tempting, too much involved with what I call the ultimate trickle-down economics, subsidizing a wealthy businessman or woman and hoping that somehow, the benefits some day will reach the poor.

I can give you chapter and verse on how some of the biggest critics of so-called trickle-down economic theory that tax rates were trickle-down economics, are in bed with promoting trickle-down programs that never even reach low-income people.

But I think it's very important that we have political accountability in our democracy. And I hope the Congress doesn't lose sight of the fact that a 2-year term and a 4-year term—in fact, I'd make you guys run every 2 years if it were up to me.

Senator **Mack**. Don't you do that.

Secretary **Kemp**. I got your attention there.

Senator **Graham**. I thought you were a Madisonian.

Secretary **Kemp**. No, I'm a Jeffersonian. I am an 18th-century liberal democrat, small L, small D.

I don't think you ought to limit your terms. I know you didn't ask me the question, but I don't think you ought to limit your terms. I don't think we ought to limit the President's term.

But beyond that, I think it's essential to have political accountability. You wouldn't have it if you careered everybody at HUD. I don't think that that would be the answer to this at all.

The answer is what you're doing and what we're trying to do and what this administration is trying to do, and what the press has done.

Sunshine every single thing that we do. I would put it all on C-SPAN. I'd put C-SPAN in my funding—well, my staff is all going to—I'm a radical democrat. I believe the more sunshine, the better. And I'm looking at two Senators from the great sunshine State, so you'll appreciate this.

But C-SPAN and CNN and the press play a great role in bringing these decisions to light. I think that is, in the long run, that is as important a reform as anything that you will find us doing at HUD, sunshining every decision and removing backroom decision-making from HUD. I'd put the C-SPAN in the Federal Reserve open market committee operations.

Senator **Mack**. I know you would. I know you would.

Secretary **Kemp**. Chairman Greenspan will appreciate that.

Senator **Mack**. Let me just touch again on the sunshine aspects of it.

You have taken that initiative. In some respects, you have recorded in the Federal Register the decisions that have been made.

Secretary **Kemp**. Right. And why? The criteria.

Senator **Mack**. I guess the bottom line is, is that something that can come and go with changes at the agency? Should we be doing something?

Secretary **Kemp**. It's in the law. It's in H.R. 1.

Senator **Mack**. OK.

Secretary **Kemp**. The most dramatic reform that I wanted to go to NSHON on—I mean, my NSHON landing for reform was to abolish the Secretary's discretion account, just to manifest and reflect the good faith that we had, that we wanted to evidence in abolishing that decisions that heretofore had been made by—I won't mention names, but were so highlighted by the press accounts and the investigations by Tom Lantos and the IG and the various committees.

And then, second, and Frank Keating needs a lot of credit for this. It was his suggestion that we not only abolish the discretionary account, among other people making that recommendation, but that we publish everything in the Federal Register, so that the press and people will have access to the reason for the decision. And all of the waivers have to go now through the assistant secretaries, or very close to it.

Waivers were being made, Connie, at the regional level, in field offices, waiving regs, waiving criteria. There weren't even criteria, in many instances.

So much to the chagrin of some of my folks at the field level or regional office, we're not trying to centralize control at HUD in our own bureaucracy, but we do want accountability for the waivers that heretofore had gone to people, all too often, for political influence reasons or profiteering or for, in the case of Dubois Guilliam, for his own profiteering. No more.

So that's in law, and unless the law is changed, the next Secretary of HUD will have to go through the same process.

Senator **Graham**. I'd like to turn now to the question of institutional capacity.

In both your prepared statement and in your presentation, you recognized the linkage between what it is you want to accomplish and your capacity to get there.

One of the issues that has recurred in our previous hearings has focused on the lack of capacity to appropriately monitor programs. That's a general concern, but it becomes a greater concern when you are shifting the form of your administration.

Example: insurance. As long as insurance was an in-house, direct insurer, then the primary focus of the Department was on how to manage an activity that was of itself.

When coinsurance became a parallel activity, that required a different relationship, which emphasized monitoring what somebody else did, rather than doing it yourself. And that seemed to be one of the key weaknesses in the coinsurance program which have led to its problems.

There has been a recent Inspector General audit of the title X program to which you have alluded, which indicates that there is a continuing hemorrhage of losses there likely to cost the Federal taxpayers $177 or more million.

There was an indication that one of the key problems there was a failure to, again, properly monitor those persons who were benefiting by this program.

Using that as an example, how do you see the reforms that you've made being applied to the title X program in, particularly, more effective monitoring?

Secretary KEMP. Let me have Frank Keating, my general counsel, take my premise to its, hopefully, logical conclusion. But let me just say, when I found title X being used for real estate development and golf course improvement and underwriting of insurance for golf courses, I went through the ceiling. We just jumped on that program and abolished it, stopped it immediately, upon recognition of this outrageously flawed program.

And there was a lot of gnashing of teeth, Bob. I mean, lots of heartburn over some in the industry. And I don't want to characterize all the men and women in a wonderful industry as bad apples. But there were some. And this program was systemically poisoned and we stopped it.

The publicity recently surrounding a decision that was made, I think Frank can go into in greater detail, but was part of a contract into which HUD had entered prior to my even taking over as Secretary of HUD.

I mean, I can't break a contract. I don't want to ruin the relationship by breaking a contract. But the ending of the program we thought sent a very strong signal to the industry that we were not going to allow this to happen in the future.

As far as monitoring goes, we monitor very carefully. Frank, why don't you take it from there?

Mr. KEATING. Mr. Chairman, as a postscript to what the Secretary said, as he indicated, when we noticed that the default rate was some 42 percent in the title X program, and that there was an adequate underwriting and adequate monitoring, and the program itself was directed towards beneficiaries and projects that did not conform to where the Secretary felt the Department should go, namely, to serve the interests of low and moderate income Americans, he proposed by regulation and ultimately by statute with reform bill that it be scrubbed.

Unfortunately, there were a number of those projects that were in the pipeline. Legally-binding commitments had been made to those projects and we couldn't wiggle out of them.

So to the extent that bad decisions had been made, we were cursed to conform legally to the carrying out of those bad decisions. But no similarly bad decisions could be made in the future because we've scrubbed the program.

Senator GRAHAM. What is your current assessment of the Department's capability of monitoring your existing responsibilities?

Secretary KEMP. Let me ask Al DelliBovi to take on this question. I have asked Al and Frank to monitor this ongoing challenge day to day under my overall direction to make sure that the reforms and management and auditing changes are put in concrete, to the extent that we can do it humanly and politically.

But, Al, do you want to take the Chairman's question under the panoply of your responsibilities as Under Secretary?

Mr. DELLIBOVI. Well, let me begin. In the office of housing, under the FHA, we've established an office of monitoring and evaluation, something that did not exist there before. In all of our programs, we're putting an emphasis on monitoring and evaluation and making that a management goal.

However, to be candid, we probably are still losing money based on past decisions. Most of our programs, many of them on the housing end, are insurance programs. And if bad risks were insured when the bill comes due because policies were issued on bad risks, we are going to have to pay.

We are monitoring that more carefully. We are, as Mr. Keating indicated, making sure that we do not insure any more bad risks, or we try to eliminate as many as we statutorily can.

In the grant programs, we have stepped up our monitoring, and throughout the agency, we are building into our systems, our financial systems, and our programmatic monitoring systems, the ability to keep track of what's going on.

As the Secretary's testimony does point out, though, this is going to be a marathon. It's not a sprint. In many of these programs, we started virtually from scratch. In the section 8 program, I would say that we started 15 years behind. A program had been in existence. There had been no planning for monitoring for 15 years, and now we're trying to catch up.

We will catch up, but we're not going to do that overnight.

Secretary KEMP. Could I add a postscript, Chairman Graham, quickly about title X?

One of the good things that's come out of this is a working relationship between the IG and the Congress and the IG and the Secretary. In other words, my door is open. His door is open. We have a hotline to each other. We call him. He calls us.

I think we have established a modus operandi between the IG and the Secretary and his staff, as well as between our IG and you all, that I think is a healthy one. I was skeptical in the beginning. I am now a full-fledged supporter of what Congress has mandated in terms of Inspector General. I asked the Inspector General to monitor all of the contracts into which we had entered, notwithstanding the fact that they were flawed from the beginning in the program. When we cancelled the program, we asked the IG to get into every single contract and monitor with us, not only through housing, as Al DelliBovi pointed out, but through the IG.

In fact, we have the IG in—gosh, how many? He and his staff are involved in ongoing audits and investigations to a degree probably unparallelled in HUD's history.

I wanted him to make sure that he and his staff would have an ongoing investigation of those previous title X contracts into which we had entered, or someone else had entered, cast, as Frank said, into our watch, so that we would know where those losses were going to be and how they could be limited to the degree that that was possible.

Senator **Graham**. Looking to the future, you talk in your report about the new HOPE program which will move towards increased homeownership, the 1 million homeowners by 1992.

Secretary **Kemp**. Among other things.

Senator **Graham**. How have you prepared the Department to accept the new responsibilities that overseeing that responsibility, as distinct from what the Department has been doing in the past, will require?

Or to put it another way, how we can assure ourselves that we aren't going to have a repetition of coinsurance by the failure to adjust institutional capacity to new mission.

Secretary **Kemp**. I don't want to overemphasize, but I don't want to minimize the importance of the espirit de corps, elan vitale, those intangible qualities that people bring to their jobs when they feel good about the ultimate aim of a program.

To wit, from day one, in the Bush administration, and in my stewardship of HUD, I have emphasized that this agency was involved in something bigger than just, as Connie Mack put it earlier, brick and mortar. We were involved in the lives and the families and the hopes and the dreams and the aspirations of all of us.

And I have said many times, Mr. Chairman, that there's a mainstream economic recovery of which we can both be proud. And it has responded with rewards for productive human activity. The reward for staying in school is generic in the mainstream lives of the American people. There are rewards for struggling and studying and getting grades and getting married and starting families and being civil, notwithstanding the social pathologies that exist all over the country. I have come into HUD with an idea that we needed to inject or incentivize the low income communities and neighborhoods and peoples, with the same rewards and the same chance to realize their dreams as are expected in that macro-economy in the suburbs of the United States.

Excuse me. It may not come out the way I meant it, but I think you can identify with the spirit.

So everybody at HUD—Democrat, Republican, liberal, conservative, African-American, Latin-American, Hispanic-American, Asian-American, Native-American—every single person at HUD knows that Bush, through Kemp, through our team, are involved in making that dream more accessible for more people.

So that has been No. 1. And they know it all the way through the length and biways of HUD's field—how many field offices do we have?

We have 81 field offices, and of course our regional offices. And 13,500 employees. I don't think that there's anybody at HUD that doesn't recognize, this is a new HUD and they're involved in recapturing the American dream, but for all people this time. Equality of opportunity—that is the guiding theme of our efforts at HUD.

No. 2, the monitoring and the effort to change the thinking of the bureaucracy has been equally challenging. Some public housing authorities in the country want to cooperate with us. Some have flat out said, we're not going to cooperate with Bush or Kemp.

There's empire-building at all levels of Government, and there have been some public housing authorities who have leaped into the fray, working with us, and there are some who have absolutely been obstreperous.

But slowly, we are gaining their confidence that we're not trying to mindlessly invoke some theory of social Darwinism or some 18th century laissez-faire model on them, that we really have at our heart the interest of helping low-income people.

And slowly but surely, we are gaining the confidence. I think that is most important to get everybody thinking, notwithstanding their own biases, that they're involved in building something bigger than just their own little pyramid and their own little empire.

So the monitoring for HOPE or homeownership involves bringing everybody into the theme and making it transcend politics. They can't be doing it for George Bush. They can't be doing it for Jack Kemp. They can't be doing it for Bob Graham. They've got to be doing it for something that's bigger than the party platform of both of our political parties.

So the monitoring of the program is everybody involved in the goal. And the legislative reforms of H.R. 1 that are instituted. And finally, the willingness of this Secretary to personally go to every single low income community and neighborhood and public housing community in the United States of America and tell them, this is a new day, that we want to work with them and that we're not involved in pushing it down on them. We're involved in making them partners in this scheme, this strategy, this design for restoring hope to their lives.

So I can tell you, Mr. Chairman, I hope you watch. I shouldn't be giving a plug to Morley Safer and "60 Minutes" and the CBS show. But they did a 15-minute segment the other night on what's happening at Cabrini Green in Chicago that would just make you feel good about the possibility and the potential and the resource that people can be when someone shows an interest in them. And your interest in this and Connie's interest in this and your willingness to go places that people have not gone before. And my willingness to do it.

I think we have probably the one issue in America that transcends the usual debate between Democrats and Republicans and conservatives and liberals. I think there really can be a synthesis on this issue of making this war on poverty successful, as opposed to just the noble intentions of 26 years ago, establishing that as a goal for America.

Senator **Graham**. Senator Mack.

Senator **Mack**. Mr. Chairman, I apologize. I'm going to have to leave and move on to another event.

But just following on for a second onto Senator Graham's question, I think that in some of the meetings, Al, that we had, or the hearings that we had over these last several months, this question about how do we assure ourselves that there will be the kind of monitoring of new programs that were absent in old programs, led me to believe that in the process of developing those new programs, part of building the system was in fact to make sure that you identified potential problem areas, areas where things could go wrong, a method to account for those, a system of not only accountability, but communication as well.

Is that it?

Secretary **Kemp**. Yes. Senator Mack, at the front-end of every program, we've asked for a risk assessment from our IG. We asked him and his staff to look at every program, at the front-end of the program, to assess the risk potential to the taxpayer and to the program itself, as we launch it.

So we plan to prepare for Senator Graham and you and this committee the type of a front-end risk assessment of homeownership and urban homesteading and enterprise zones. I will be happy to provide that for the record and for your continual efforts in this area.

We've asked for $25 million in our budget alone for monitoring and evaluating the program as it is ongoing. So I believe that our front-end risk assessment approach, coupled with our monitoring and evaluation, overlaying the interest of the Congress and, of course, my own team, I think we have put in place a broadly based and vertically applicable evaluation and monitoring system that will help prevent—I can't say that there will never be another problem, nor would you even ask that yourself. But I can tell you I think we've got a handle on it.

Senator **Mack**. The last area for me and then, again, I'm going to have to go.

One of the things, as you know, I've been on this housing issue and the housing subcommittee now for just a little over, or I guess getting close to a year-and-a-half. One of the things that really struck me as I try to make myself more knowledgeable about HUD and housing, is how complicated, how many programs there are, how complicated the programs are, which indicates, one, tremendous demand as to the skills that are necessary in HUD to make sure that you've got people of the quality that can, in essence, compete with those who are trying to get programs through HUD.

How much consideration has been given to trying to make these our efforts to provide assistance less complicated, more productive?

Secretary **Kemp**. Well, vouchers, with all due respect to their critics, vouchers have channelled assistance directly to low-income families. I'm not suggesting they work the same in every market because I would be foolish to try to make that case.

Nonetheless, they can play a powerful role as a tool of empowerment to giving people choice as consumers and treating them with a little bit more dignity where they can even save some money, as opposed to suggesting that we know best and we are going to put you into a housing project and stack you on high, and put you into these little—I'm going to use the phrase, ghettoized, communities, not to attack the people, but to attack the idea of that plantation mentality, that we know better how people would want to live than they themselves.

In any close analysis of what happened in moving from direct subsidies for construction to subsidizing families directly, I think history will look far more favorably on that experiment than has heretofore been acknowledged by its critics.

It is not the sole tool, but it is a very important tool, and I would encourage you and Senator Graham to help us advance the idea that we want to expand that program where it is applicable to the needs of the family and low-income people.

It's not the only tool, but it's an important tool.

Senator **Mack**. Thank you, Mr. Secretary.

Senator **Graham**. Senator Mack is going to have to leave, and we have just started a rollcall.

Mr. Secretary, I hope that I can ask for your indulgence for a brief recess to vote, and I will return as quickly as possible. I have a few final questions.

Secretary **Kemp**. OK. Good. Good. Thank you.

[Recess.]

Senator **Graham**. Mr. Secretary, we're going to have another vote shortly, and I appreciate your indulgence with this recess. I'll try to avoid you having to put up with another one.

So I'd like to ask——

Secretary **Kemp**. Just so it doesn't carry over into the NBA playoffs and ruin the game. [Laughter.]

Senator **Graham**. It will not do that.

Secretary **Kemp**. I want to watch Michael Jordan.

Senator **Graham**. If we have some further questions, we would like to be able to submit them to you and your colleagues for response.

Secretary **Kemp**. Yes, sir.

Senator **Graham**. And we would ask, if you could give them prompt attention, because it's our objective to try to conclude the work of this subcommittee as expeditiously as possible and have our report and actually disband and go onto something else, which occasionally happens in government, but it is sufficiently infrequent, that it's worth noting when it does occur.

I'd like to go back to the question I was raising, and that is preparing for change And if I could use an example from my own experience. When I was governor, we made some shifts in our programs of services to the elderly to try to move away from what had been a predominantly nursing home program to a broader range of services. We found that we needed to make some institutional changes within the social service agency because the skills that were required to oversee nursing homes weren't necessarily the skills required for case management dealing with different providers, a more decentralized system.

My question is, with as much detail as you think appropriate, how do you view the changes in selection, training, management, staff, level of centralization and decisionmaking, and other factors that will be the necessary concomitance for the HOPE program?

Secretary **Kemp**. Well, we have systematically, Mr. Chairman, brought into training every employee involved in a program that would have anything to do with HUD's generic function, as well as our vertical function in each program area of aiming at homeownership as the guiding theme of HUD.

People in the field and out in the regions are invited in. Our people in the program areas, such as housing, or community planning and development, or in public and Indian housing, are in the field.

So there's a constant exchange of ideas and disciplines and functions in all of the areas vertically, as well as the new spirit that I think we have brought to HUD, as well as doing something beyond that, Mr. Chairman, which is to go out to the people themselves.

But what we've done is bring the people into the program and listen to them.

For the first time, I can honestly say I believe the Federal Government, at least at HUD, is involving the people themselves in the training, in the program analysis, in the system that we hope to design and leave as our legacy. And I feel very good about that.

There's tremendous talent and potential out there.

Senator GRAHAM. In summary, are you saying that you believe that you are organizationally prepared to take on this new responsibility?

Secretary KEMP. Yes, organizationally. Now, that isn't to say that we're not going to need more staff in housing, more staff in the general counsel's office, more staff in monitoring, more money in evaluation, more of an ongoing effort.

But I want you to know I believe that we can, given the resources that we have at our disposal, and that we hope to get, with the cooperation of the Congress in our 1991 budget, I am convinced that these reforms can be both ongoing and perpetual, as well as meeting the high-standards that you have set, as well as President Bush has set for the agency overall.

Do you want to add, Al DelliBovi?

Mr. DELLIBOVI. I would just say, Mr. Chairman, that, beginning with front-end risk assessment on new programs, we intend to follow that up by designing programs in such a way that they can be administered, by training the people to administer them.

We have had successes in the last year. In fair housing, when our responsibility changed from basically conciliation to enforcement, we took an existing staff, retrained them, redirected them, and we are having success now under the new responsibilities under our Assistant Secretary, Gordon Mansfield.

So there's been some success stories and we have shown that we can change the culture and retrain our people. It's not always easy and we do have the problems as we had in fair housing, with an existing workforce that was not enforcement-oriented, and we had reorient them.

And I won't say that we've totally reoriented all of them, but I believe we've made a lot more progress in that area than we might have expected.

So we're committed to doing it.

Senator GRAHAM. I'd like to look back at some of the residue of what happened in the 1980's. One of that area of residue are the malfactors, the people who did abuse and benefited by the system.

What is the Department doing now to identify those circumstances, instances which might reach the level of criminal abuse, referred to the Department of Justice, if that's the appropriate agency, and those that might have the opportunity for recapture of excess windfalls for civil action?

Senator GRAHAM. Mr. Chairman, on this question, I'm going to ask my very able General Counsel, Frank Keating, who has been not only day-to-day involved in the ongoing analysis of these problems, but is in full cooperation with our Inspector General, the Government Operations Committee in the House, in the Senate, with your staff, Mr. Chairman, with GAO, with the Attorney General.

I would say one of the blessings of my first year-and-a-half at HUD has been to have at my side someone like Frank Keating who has such incredible ability in this area, and I'd like him to give you a quick review of what he and our staff are doing to continue to ferret out any criminal activity, and to recapture taxpayer funds so it could be rechannelled into more productive areas.

Frank, after that incredible introduction, do you want to answer? That's in lieu of a pay raise, Mr. Chairman.

Mr. KEATING. I was going to ask for a little money with that. But, unfortunately, I guess that's not forthcoming. (Laughter.)

Mr. Chairman, I might note, again as a postscript to what the Chairman said, when he first came aboard, one of the first things that we did was to sit down with the Inspector General and go over all of the IG reports.

Now, the systemic, programmatic weaknesses, Al DelliBovi took over in the management side. But those which suggested the opportunity for civil recovery or criminal action were collated and provided to the Department of Justice immediately.

Our Inspector General and Secretary Kemp's senior staff, we meet on a weekly basis, every week, like clockwork, and go over any of the ongoing investigations, any of the matters which are under review, to see to it that action is taken.

The Department of Justice, as you know, is responsible——

Senator GRAHAM. Do you know approximately how many cases have been referred to Justice thus far?

Mr. KEATING. Well, only the individual findings of maladministration, not particularly criminal conduct, but potential criminal conduct, maladministration, I'd say probably several dozen would be the maximum.

But I might say, we also, after the Secretary's insistence, created an asset recovery strike force within HUD, under Associate General Counsel John Kennedy's direction. We have filed 17 cases, and I believe recovered $7 million to date, against individuals who have abused HUD programs that we identified that did not constitute criminal conduct, nor excessive civil misconduct where we needed the Justice Department to look at it first before we acted.

But we meet with the Justice Department on a periodic basis. We have liaison with them. And we have provided them all of the resources from our Department and all of the assistance that they need to move forward as they see fit.

But, of course, we can't tell them who to prosecute or who to sue. All we can do is ask them to help us.

Senator GRAHAM. Do you believe that for those areas that are within your responsibility, that you have sufficient capability to pursue that, and for those that have been referred to the Department of Justice, that DoJ has indicated that it is capable of properly handling these cases?

Mr. KEATING. Well, let me start with the Department of Justice first.

I don't know whether or not they have sufficient resources to help us. I understand that they have several thousand cases over there that are FDIC, S&L-related cases that are awaiting completion of investigation and prosecution.

I know that within the U.S. Attorney community, they have been very forthcoming and very responsive to us with our cases. And the Secretary instructed our Inspector General to meet with every U.S. Attorney, which they have done, to ask every U.S. Attorney for their cooperation, which has been done.

And I'm informed that these 17-odd cases that we have filed and the recoveries that we have enjoyed to date, have been able to be done within existing resources. And the weekly meetings that we've had with the Inspector General have not resulted in any major request from our own Inspector General for additional assistance.

But I can assure you, and I'm sure I'm mirroring Secretary Kemp when I say this, that if those resources are needed in order to get back the taxpayers' money, we will request them.

Senator GRAHAM. And would you also—excuse me. As anticipated, we've started another 15-minute rollcall. I'm going to take another 5 or 6 minutes for some questions and then we will adjourn this hearing. And again, I appreciate it.

So in light of that, I'm going to try to ask short, precise questions, and if you could attempt to accommodate our time.

If you have any sense that the Department of Justice is not able to properly handle the cases and you sense the need for additional capacity, the committee would appreciate it if you would point that out.

We want to be your ally in assuring that you have the resources to effectively deal with this aspect.

One other of the look-back issues is, Mr. Secretary, you serve lots of masters now—HUD, RTC, other responsibilities. And particularly as it relates to RTC and to HUD, inventory of defaults, you have a major marketing responsibility. One issue that's been raised is the question of whether HUD has or should have the capacity to provide some long-term credit to facilitate the disposition of these inventories.

What is your sense of the current HUD capability to mitigate the Federal Government's losses by making such credit or credit insurance or credit enhancement arrangements available?

Secretary KEMP. Well, and I would like Al DelliBovi to also comment on this, but I would say, generally speaking, I do favor the type of policy that would be not only sensitive to the real estate market in terms of not depressing an already burdened real estate market in those areas of the oil patch, energy patch. But I do favor generally a strategy of moving with dispatch to move these properties back into the hands of those who can add value to the property.

It makes no sense to see this in any way other than as a drain on the taxpayer and the resources of the country.

Senator GRAHAM. And with that goal——

Secretary KEMP. So I favor seller financing, deep discounts, auctions, bulk sales, given, of course, our sensitivity to different market conditions.

We do not——

Senator GRAHAM. What about the issue of HUD's participation in as lender, either primary insurer——

Secretary **Kemp**. I was going to add that to my responsibilities at HUD. FHA does now, and will in the future, continue to insure FHA properties as a buyer would qualify.

So we're in that business through FHA. But I was alluding more to the hat I wear on the oversight board of the RTC, with Mr. Brady and Mr. Greenspan. And I'm also the chairman, thanks to Congress, de facto, well, actually, de jure, of the Federal Housing Finance Board, until the new chairman is confirmed by the U.S. Senate. We've sent his name up.

So, I've got to be careful that I distinguish between the different responsibilities—HUD, FHA, Federal Housing Finance Board, and RTC oversight.

But my general philosophy is to use discounts, to use seller financing, to use auctions, to use bulk sales, where appropriate, sensitive as we must be, to market conditions, and then to continue to promote FHA as a way of getting help to low-income people. We're going to set aside FHA properties and leased and nonprofits for a dollar a year, some of our inventory that can help the homeless.

So we have a broad strategy, Mr. Chairman, of insurance, discounting, working with nonprofits, working with state financing agencies, to encourage affordable housing, helping the homeless, and of course, adding value to the tremendous inventory through RTC of those properties, and I hope with dispatch our move back into the private sector.

Al DelliBovi is one of my representatives on all of these various functions, and I'm going to ask him maybe to give a quick analysis of where he would add to my comment.

Mr. **DelliBovi**. Mr. Chairman, we're proceeding cautiously. We're trying to leverage all of those tools. We do want to be careful that we do not create a new class of investor-profiteers, as it were, or create new opportunities. So we do have to proceed very carefully.

But we are using each of these techniques with each of these agencies, and willing to work with the RTC as well.

Senator **Graham**. We're into the last 8 minutes of this vote and I'm going to have to leave.

As I indicated, we would like to be able to submit some additional questions. One area that I wish we'd been able to go into, but you discussed it in some of your earlier responses to Senator Mack's questions is the issue of vouchers and the relationship of demand enhancement programs as they affect the mission of the Department and the Department's ability to carry it out, as opposed to supply improvements.

We'll try to submit some questions to further pursue that issue.

Secretary **Kemp**. I'd be happy to, Mr. Chairman.

Senator **Graham**. Good.

Secretary **Kemp**. The President has announced a Blue Ribbon Commission, and we are having our first meeting next week. A couple of Floridians are on it. We are going to spend 1 year studying barriers to affordable housing, by zoning, NIMBY syndromes—Not In My Back Yard syndromes—building codes, exclusivity of zoning, rent controls.

I can tell you, sir, it will be bipartisan. Commissioner Barbara Carrie serves on that commission, a number of distinguished American public and private citizens. And I think this will also be of interest to this committee because, in some cases, local communities are doing things to their own affordable housing for low-income people that defy the belief that the American dream is being offered to people.

I mean, they're just saying, we don't want any development of low-income housing in our neighborhoods. And they use their zoning laws to restrict it.

I plan to focus a lot of attention in this year at HUD on what those barriers have done to remove that dream from becoming a reality to low income people.

We appreciate it.

Senator **GRAHAM**. Well, thank you very much, Mr. Secretary.

Secretary **KEMP**. Thank you. Thank you, Mr. Chairman.

Senator **GRAHAM**. Thank you. Gentlemen, Mr. Keating, Mr. DelliBovi, we appreciate your participation and your contribution to our understanding, and to what I hope will be some constructive recommendations.

Thank you.

Secretary **KEMP**. Thank you, Mr. Chairman. We look forward to working with you.

Senator **GRAHAM**. Good. Thank you.

[Whereupon, at 12:55 p.m., the hearing was adjourned.]

HUD IG AND SECRETARY'S SEMI-ANNUAL REPORTS

FRIDAY, JUNE 29, 1990

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,
HUD/MOD REHAB INVESTIGATION SUBCOMMITTEE,
Washington, DC.

The subcommittee met at 10:06 a.m. in room SH-216 of the Hart Senate Office Building, Senator Bob Graham (chairman of the subcommittee) presiding.

OPENING STATEMENT OF SENATOR GRAHAM

Senator **GRAHAM**. Good morning.

We have invited Mr. Paul Adams to appear before this subcommittee on a number of occasions during the course of our investigations, and on each of those occasions we have been illuminated by his comments and observations.

In his last appearance on May the 8, we were exploring the role of Congress in its oversight of HUD and the warnings Mr. Adams and his predecessor, Mr. Charles Dempsey, had given Congress and the President in their semi-annual Inspector General reports during the 1980's.

At that hearing we discussed with Mr. Adams the need for hearings for the receipt of those reports so that Congress might give them the attention which they fully warrant.

We also discussed the need for such hearings to receive and discuss the Department's annual report pursuant to the Federal Manager's Financial Integrity Act. We do not mean to suggest that such hearings would satisfy the need for oversight, but that they would be an important step towards focusing the attention of Congress upon clearly-identified problems at the Agency.

Last month the Inspector General released his latest, semi-annual report covering the 6 month period which ended March 31, 1990. We believe it's appropriate for this subcommittee to receive that report and discuss the problems which are highlighted therein. Some of those problems are further evidence of concerns that have been revealed in other hearings before this subcommittee.

We continue to applaud the continuing efforts of Secretary Kemp to address weaknesses in the Department. We are nonetheless concerned that many problems continue to exist.

The Inspector General's Act was amended in 1988 to require the Secretary to submit to Congress and the President a semi-annual report in response to the Inspector General's report. We are pleased to have with us today Under Secretary Al DelliBovi to present that report. We hope to learn the actions being taken by the Department to correct its many problems.

Finally, we are concerned about the status of criminal investigations relating to HUD. This year revealed a startling number of instances of alleged criminal activity.

For example, just last week, Marilyn Harrell was sentenced for stealing HUD funds, for her role as a closing escrow agent involved in the disposition of HUD properties under the Single Family Housing Program. She had received notoriety after being labeled "Robin HUD" by the media for allegedly diverting many of those funds to charity.

The Independent Counsel, Judge Arlin Adams, has recently been requested by the Attorney General to review the testimony of DuBois Gilliam before Representative Lantos' subcommittee for possible expansion of his limited jurisdiction.

Other criminal investigations are under way and, of course, we do not mean to explore matters that must remain confidential or otherwise might impede those investigations. To the contrary, we are anxious that they proceed.

We are mindful of the calls for criminal prosecutions of those involved in the savings and loan crisis. The public must know that there, as well as with HUD, persons responsible for fraud and substantial loss of Federal funds will be held responsible.

We intend to explore the relationship of the Inspector General of the Department with the Department of Justice to assure ourselves that that relationship is working and that those who take advantage of the Department and its programs will be held accountable for their actions. We have a panel with us today to explore those issues.

This will be the final hearing of this subcommittee. Subcommittee staff is currently preparing the report of the subcommittee, which we hope we'll have ready for release by late summer.

Before proceeding to the first panel, I wish to express my appreciation for the outstanding work which the staff, led by Mr. Sandy D'Alemberte, Mr. Jim Watt, Bill Leary and others have done throughout the course of these hearings.

We started with the directive that we were going to try to better understand this Department and why it had been vulnerable to the abuses to which it had been subjected. I believe that with their assistance that we have been led through a very significant diagnosis and will be in a position to prescribe to the Congress, to the administration and to the public some necessary medications in hopes of arming this Department against such abuse in the future.

Before we start, I have a statement from Senator Mack that will be inserted in the record.

OPENING STATEMENT OF SENATOR CONNIE MACK

I am very pleased to participate in today's hearing. Not long ago, we heard Secretary Kemp's testimony in what we had planned to be this subcommittee's last hearing.

With the arrival of the Inspector General's semi-annual report to Congress from the U.S. Department of Housing and Urban Development, I agreed with Chairman Graham that we should hold one final additional hearing on this topic.

In fact, I think the precedent being set today by this hearing is extremely important.

Throughout the course of this subcommittee's investigation, we have seen how both the executive and the legislative branches of Government contributed to the problems at HUD. We have found that the Congress was largely responsible for the problems in both its flawled housing policies and its poor oversight.

We have just passed a housing bill that will hopefully address some of those policy issues, although I still believe we have a long way to go in moving away from complicated, prone-to-abuse production programs.

The congressional oversight function, however, is equally as important, and ought not be overlooked. That's why I believe the process of conducting this hearing—on the I.G.'s report—is of critical importance. The reason is simple. Time constraints almost require that formal hearings be held if proper attention is to be given to the reports. In the absence of a hearing, we have seen too many I.G. reports go unnoticed, filed, or even tossed.

I commend the Chairman for beginning this important precedent and would urge each of the authorizing committees to do the same.

Mr. Adams.

Senator Graham.

STATEMENT OF PAUL ADAMS, INSPECTOR GENERAL, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, ACCOMPANIED BY CHRIS GREER, ASSISTANT INSPECTOR GENERAL FOR AUDITS AND PATRICK NERI, ASSISTANT INSPECTOR GENERAL FOR INVESTIGATIONS

Mr. Adams. Thank you, Mr. Chairman.

I'd like to also thank you and the subcommittee staffers for your assistance throughout this process. I think it's been a very constructive process.

Before I begin my testimony on the details of my report today, I'd like to make a couple of general comments to place things in context.

Audits and investigations, by their very nature, almost always look back on past events in order to develop suggestions for improved operations in the future or for possible criminal proceedings. Thus, for the most part, our recent reports describe conditions that existed prior to Secretary Kemp's arrival at HUD.

As you know, the Kemp team has, with the cooperation of the Congress, begun to initiate numerous corrective actions. And it won't be very much longer before our reports begin focusing on the effectiveness of those actions. However, with few exceptions, the matters we will be reporting on today are management problems carried forward from the previous administration.

The best way to begin my testimony is a statistical view of the results seen in the aggregate of the cash recoveries, the criminal actions and the administrative sanctions and to briefly describe those.

The Department recovered some $18.6 million during the previous 6 months as a result of our audit and investigation work. They also made commitments to recover an additional $63-million-plus. There were criminal indictments of 185 individuals and firms and 144 convictions. On the administrative side, there were some 55 suspensions and 44 debarments of individuals and firms doing business with the Department.

Although these numbers provide some sense of our accomplishments, the more important effects of our work are not quantifiable in the traditional sense. Improvements in the economy and efficiency of the programs and the prevention of fraud and abuse have more long-range impact and are far greater in importance.

In our September 1989 semi-annual report, we provided an overview of the Department's major problems. In the current report we provided an updated status of those 9 problem areas, and let me briefly enumerate those. Those are: Internal Controls, Single Family Mortgage Insurance Program, the section 8 Program Discretionary Funding, Coinsurance Program, title I, Retirement Service Centers, title X Land Development, Multifamily Loan Servicing and the Government National Mortgage Association. As you mentioned earlier, in most of these areas changes have been made and are in progress; however, work still remains to be done.

Turning to the area of the significant audits during the reporting period, we have about 7 of those we'd like to briefly bring to your attention. Those are the Public Housing Agency Decontrol Program, the Comprehensive Improvement Assistance Program, the Passaic, New Jersey Housing Authority, Housing Development Corporations, once again the Retirement Service Centers, Housing Development Grant Program, and the program income in the Community Development Block Grant area.

Each of those audits is described in detail in my statement and again in the semi-annual report. With your permission, I will not summarize those at this point but to try to give you my perception of the Departments' actions in general with respect to those and other findings.

Audit follow-up on the conditions we've identified has become a very high priority area for the Department. The Secretary and his staff have given it high-level attention and commitment, with the Under Secretary being designated as the Departmental audit follow-up official. While management is primarily responsible for assuring implementation of the audit recommendations, we view it as a shared responsibility, and to that end we work daily with the Under Secretary's staff, the senior staff and the audit liaison officials throughout the Department.

A final phase of the audit follow-up process is the corrective action verification. In selected cases, especially those where final actions involve implementation of new procedures or methodologies, we visit the auditee to verify that final action was actually consistent with the audit recommendation.

During the preceding 6 months, we've continued to focus our investigative efforts on the continued cooperation with the Department of Justice and the FBI in the criminal prosecution of those found wanting. We enjoy, I believe, a very close working relationship which spans many years.

Of special interest to this subcommittee is the Moderate Rehabilitation Program. We currently have assigned one agent to independent counsel Judge Arlin Adams' staff and we will soon be sending a second person to work on that staff also.

In our efforts to further enhance our relationship with the Department of Justice, we are planning to hold a joint conference in the fall of this year with the FBI. That conference will focus on the need for cooperative efforts to detect, investigate and prosecute fraud in HUD programs. We were pleased to sponsor a similar program last January—January of 1989, that is—in which we brought together about 100 investigators and prosecutors throughout the country to focus on HUD and its related problems. We believe that was very successful because it intensified the interest and the concern on the HUD programs.

At the present time we have about 700 cases pending, many of which we are working jointly with the FBI. There are about 200 cases pending with U.S. Attorneys. There have been indictments in some of these cases and others are awaiting a prosecutive determination. The FBI also has about 650 HUD investigations, many of which we're assisting them with.

You earlier mentioned the well-publicized frauds involving the closing agents and the recent sentencing of Marilyn Harrell, the infamous "Robin HUD." I would just like to repeat a couple of items. Last week she was sentenced to 46 months in prison and ordered to make restitution of about $600,000. I might comment that the prosecutor sought and obtained a sentencing which was above and beyond the sentencing guidelines because of the nature of the crime.

There are other investigations—there have to date actually been 7 prosecutive actions with respect to closing agents and there are 9 other cases pending. We're working closely with the Department of Justice Civil Division to be sure that appropriate civil action is considered throughout those also.

One other area of investigations that we're concerned about is the continued question of rental assistance. During the 6 month reporting period there were 49 individuals indicted and some 43 convictions, some $464,000-plus in restitutions and repayments and some $79,000 in fines imposed.

To kind of quickly give you a sense of those, we're concerned because those violations deprive other individuals of rental assistance because of the limited number of dollars available.

And to quickly share with you an example of one case would be a former tenant in Boston who plead guilty to certifying falsely his income during a 3-year period in which he earned over $106,000 and received some $27,000 in excess subsidy payments; thereby depriving another individual of that same amount of money.

Our last area of on-going work is prevention. We're concerned about preventing fraud rather than trying to detect it after the fact; so we're working very actively with the Secretary and his principal staff in the Front End Risk Assessment Program. We look at new and modified programs as they come on line to assure ourselves that proper internal controls are in place that will hopefully prevent the problems rather than us having to detect them afterwards.

Another area of the prevention we're concerned with—I mentioned the Rental Assistance Program earlier—is two new initiatives to detect and prevent fraud in the tenant fraud area. That is known as our Tenant Integrity Program and income computer matching.

The program, consists of workshops whereby we instruct PHA staffs and others on how to prevent, detect and take action in connection with this fraud and error. This is a program that we developed, piloted and we're in the process of now training trainers who will actually carry out the future training. We are working with professional associations and private contractors. Currently there are over 47 workshops scheduled.

As concerns computer matching, during the previous 6 months we completed three; in Denver, New Haven and Hartford. We found some 316 families who had underreported income of $6.2 million and thereby receiving $1.8 million in excess rental benefits.

You also requested that we comment on the HUD staffing resources question in the Department. I'd like to turn to that with your permission.

It is our opinion that the HUD staff resources in terms of numbers and expertise are not currently available to deal with the myriad problems facing the Department today. Our opinion is not based upon any comprehensive analysis of overall staff needs; rather, it is based on a historical perspective that spans many years. We attribute many of HUD's problems to critical staff shortages.

As an example, our audit report on the Retirement Service Centers disclosed that HUD staff lacked the necessary expertise and training in this very unique area.

We also estimated that HUD's underwriting workload could increase by 25 staff years if the Department decides to continue the Retirement Service Center Program and undertakes that underwriting responsibility itself.

The Retirement Service Center is a program with only about 190 projects and only 82 of those are coinsured. Therefore it's very tiny in comparison to the entire coinsurance program. However, it does demonstrate the type of staggering problems facing the Assistant Secretary and her staff.

Congressional hearings over the past year clearly established that the coinsurance concept was a dismal failure. The Kemp team took very aggressive steps to deal with the failed program prospectively. However, making what we consider to be the right move has in turn created tremendous workload pressures. HUD staff now is faced with the prospect of dealing with the failed lenders and with hundreds of defaulted projects. At the same time that staff must attempt to maintain an active loan servicing workload to prevent future defaults and begin to prepare for the implementation of the new program.

A somewhat similar condition is faced by the Assistant Secretary for Public and Indian Housing as they have suspended the decontrol program and are re-evaluating that and coming up with an alternate program. They will be faced with similar conditions.

Several other audit reports point out more traditional problems at HUD, and these problems relate to ineffective staff monitoring of program participants. Monitoring weaknesses were described in our audits of the Block Grant Program Income and Miscellaneous Revenue, the Comprehensive Improvement Assistance Program and the Housing Development Grant Program.

The common theme in these reports is that staff was not available in sufficient numbers or qualifications to carry out the monitoring role. Consequently HUD funds were wasted or were used for ineligible purposes.

In responding to these reports, the assistant secretaries generally agreed that staffing shortages and skill imbalances contributed to the weaknesses we reported. Competing priorities diverted available staff to other areas. In addition, the assistant secretaries pointed out the need for more training to upgrade staff capability to review rather complex financial transactions.

In summary, our reports over the past 6 months pointed out some very specific areas where HUD management needs to assure that staff resources, either permanent staff or contractor staff, are assigned to take corrective actions.

And last, on a very personal note, I would like to point out that a substantial increase in my own staff will be required to accomplish the work that remains to be done. Additional positions were approved in 1990's budget but, as a result of sequestration, we were unable to fund those positions. Our 1992 budget requests will also reflect the requests for additional staff. Our ability to provide vital assistance to the FBI and the U.S. Attorneys in the prosecution of HUD cases is largely dependent upon our success in obtaining these additional resources.

Mr. Chairman, I'm optimistic that HUD is going in the right direction and please be assured that my office stands ready to assist in any way possible to keep that momentum going in that direction.

Thank you and that concludes my remarks.

[The complete statement of Paul A. Adams follows:]

Statement of
Paul A. Adams, Inspector General
Department of Housing and Urban Development
Accompanied by
Chris Greer, Assistant Inspector General for Audit
and Pat Neri, Assistant Inspector General for Investigation

Before the Subcommittee on HUD/Mod Rehab Investigation
of the Committee on Banking, Housing, and Urban Affairs
U.S. Senate
June 29, 1990

Mr. Chairman and members of the Subcommittee, I appreciate the opportunity to appear before you today to provide an overview of our audit and investigative activities during the past 6 months.

Last month I testified before this Subcommittee. At that time I suggested that Congress take a more active role in reviewing the work of Inspectors General and in holding Departmental managers accountable for taking needed corrective action when problems are noted. Mr. Chairman, I believe your hearing this morning is a good first step in this direction.

Before getting into the specific details of our most recent Semiannual report, I think it is important to put my comments this morning in perspective. Audits and investigations by their very nature almost always look back on past events in order to develop suggestions for improved operations in the future or for possible criminal proceedings. Thus, for the most part, our recent reports describe conditions that existed prior to Secretary Kemp's arrival at HUD. As you know, the Kemp team has, with the cooperation of Congress, begun to initiate numerous corrective actions. It won't be very much longer before our reports begin focusing on the effectiveness of those actions. However, with few exceptions the matters we are reporting today are management problems carried over from the prior HUD administration.

Our 23rd Semiannual Report to Congress, which was released May 31, covers the period from October 1, 1989 through March 31, 1990. I would like to give brief highlights of the issues contained in that report. This includes audit, investigation, and a third category that is growing in importance--prevention. As requested, I will also comment on HUD's staffing resources.

THE SEMIANNUAL REPORT

A statistical view of OIG results is seen in the aggregate of cash returns, criminal cases and administrative sanctions. The Department recovered $18.6 million in the 6-month reporting period as a result of our audits and investigations, and HUD management made commitments to recover another $62.3 million. There were criminal indictments of 185 individuals and firms and 144 convictions. There were 53 suspensions and 44 debarments of individuals doing business with HUD.

Although these numbers provide some sense of our accomplishments, the most important effects of our work are not quantifiable. Improvements in the economy and efficiency of programs and the prevention of fraud and abuse have more long-range impact and far greater importance.

OVERVIEW OF MAJOR PROBLEMS

In the September 1989 Semiannual Report, we provided an overview of the Department's major problems. In the current report we updated the status of these nine problem areas: Internal Controls, Single Family Mortgage Insurance Program, Section 8 Discretionary Funding, Coinsurance Program, Title I, Retirement Service Centers (RESC), Title X Land Development, Multifamily Loan Servicing, and Government National Mortgage Association (GNMA). In most of these areas, changes were made in response to our reports, but work still needs to be done.

Inadequate internal controls throughout the Department remained the leading problem at the close of the 6-month reporting period. Since 1983, 90 material weaknesses have been identified, mostly through our audits.

Secretary Kemp has initiated several actions to address the Department's internal control weaknesses. These include creating the position of Chief Financial Officer, establishing Comptrollers for the five major program areas, issuing a candid assurance statement under the Federal Managers Financial Integrity Act (FMFIA), and completing studies of 26 areas representing 95 percent of HUD's budget.

Chapter 1 of the Semiannual report provides details on these long-standing problems and the Departmental initiatives in progress.

AUDIT

Significant audits of the period are described in Chapter 2 of the Semiannual Report. These included the Public Housing Agency (PHA) Decontrol Program; the Comprehensive Improvement Assistance Program (CIAP); the Passaic, New Jersey PHA; Housing Development Corporations; RESC; Housing Development Grant Program (HODAG); and program income in the Community Development Block Grant Program (CDBG).

The PHA Decontrol Program was intended to give well run agencies greater flexibility, allowing HUD to concentrate its monitoring resources on problem agencies. About 20 percent of all PHA's were decontrolled. In an audit of the Philadelphia region, where 50 percent of PHA's were decontrolled, we found that the program was not implemented effectively. Out of 17 PHA's sampled, 15 were deficient in at least one of the seven standards for decontrol. Expected benefits of the program did not ensue. PHA's saw no advantage to being decontrolled, and none of the Field Offices included in our audit shifted monitoring priorities to focus on troubled PHA's. The Department suspended the program and is designing a replacement with more meaningful standards.

PHA's administering CIAP had serious weaknesses in compliance with contract administration and cost eligibility requirements. Out of 34 PHA's audited, 28 had weak or nonexistent controls over their modernization contractors. For example, 21 of the PHA's awarded $4.2 million in contracts without obtaining bids. Change orders totalling $1.4 million were made without HUD approvals or justification. Lack of review of invoices caused duplicate and unnecessary payments of $842,000. We also identified $4.6 million in ineligible and unsupported costs. HUD monitoring of CIAP needed improvement in 8 of 21 Field Offices included in the audit. The Department initiated regulatory and monitoring changes to correct the deficiencies. Regional corrective action plans are to be certified as completed by September 30, 1990.

Our audit of the Passaic, New Jersey PHA disclosed $1.1 million in questionable expenses, including compensation to the executive director at three times the budgeted rate. Salaries of the executive director and others were inflated by multiple job titles, bonuses, compensatory time, a retirement annuity, and excessive travel allowances. Because of irregularities in handling CIAP funds, the agency incurred $90,000 of ineligible costs and avoided recapture by HUD of $1.4 million.

When the Passaic PHA commissioners refused to take responsibility for the problems, HUD took over direct management of the agency. HUD is still in control of the agency while various court cases are in process. Earlier this month, the former deputy executive director and former chief of operations admitted to criminal charges of conspiring with the former executive director to obstruct our audit. The former maintenance chief admitted to criminal charges related to misusing PHA funds to purchase and install heating equipment at the executive director's home. Their sentencing is scheduled for September.

Housing Development Corporations (HDC), a nonprofit arm of many PHA's, became a concern after we found that they are almost totally unregulated by the Department. HDC's are established under State laws to perform housing-related activities on behalf of PHA's. There are no HUD regulations concerning the establishment and operation of HDC's. Neither is there guidance to Field Offices for review of HDC's. Interrelationships between these corporations and the HUD-funded PHA's may jeopardize agency assets and HUD's interests may not be adequately protected. Some of our concerns are project syndications, contracts for services, HDC involvement in activities the PHA could not perform directly, withholding of fiscal information from HUD, and use of HUD funding as collateral for HDC debts. We recommended a study of the legal status of the corporations.

The RESC program was suspended by Secretary Kemp because the program may not be adequately serving the needy elderly. In our audit, we questioned the affordability of the program for the target group and recommended termination or restructuring of the program. One-third of the 190 projects totalling $1.6 billion were in default or troubled status. Underwriting deficiencies were the primary problem, both for HUD-insured and coinsured loans. There was underestimation of expenses and overestimation of income, cash flows and project absorption rates. HUD field economist recommendations against projects were often overruled by Headquarters after appeals by project sponsors or lenders. We originally questioned the Department's decision to implement RESC in 1983 without first assessing the risks and benefits of HUD involvement in underwriting such loans. The impact was compounded when coinsurance lending was permitted in 1985. While agreeing with the overall thrust of our findings in this audit, HUD management has deferred a decision pending completion of a policy study to determine if RESC can be restructured to accommodate lower income households.

HODAG grants to State and local governments are intended to support new construction or substantial rehabilitation of rental housing. Grants are used for loans, grants, interest reduction or other assistance to property owners. In the 5 years since the HODAG program was established, only 8 of 249 projects had completed the settlement process. We noted that HUD was not monitoring grantees and the grantees were not monitoring owners. As a result, there were delayed settlements, $3 million in questionable expenditures and other noncompliance with program requirements. Understaffing in HUD's Field Office Housing Development Division contributed to the problems. HUD did not emphasize monitoring of HODAG grants for the first 4 years of the program. We recommended development of a staffing plan to assure effective review of approximately 240 project settlements.

CDBG program income and miscellaneous income were neither reported adequately nor spent properly. In an audit of 29 local grantees, we identified $20 million of program income not reported as required and $19 million spent for ineligible or unsupported purposes. Program income originates from interest on Federal funds, sale of properties and other Title I activities. Miscellaneous revenue comes from loan repayments from Urban Development Action Grant projects. Both program income and miscellaneous revenue are to be used only for Title I purposes. We found that HUD monitoring was ineffective and poorly documented. Regulations and instructions on miscellaneous revenue do not adequately address accountability and use issues.

Chapter 2 also contains reports on audits of the Housing Voucher Program, accounting and budgeting for Section 8 funds, Moderate Rehabilitation program projects, the Title X program, single family mortgages, property disposition activities, multifamily owners/management agents, CDBG Rehabilitation program, GNMA subservicing, and administrative issues. Highlights of these reports follow:

- The Section 8 Housing Voucher program, which subsidizes market rate rentals for low-income people, had deficiencies in setting payment levels and in processing tenant applications. There were also problems concerning line item budget restrictions on PHA's and the "portability" feature, which permits tenants to use vouchers in a different PHA's jurisdiction.

- HUD's system of accounting and budgeting for Section 8 funds is unreliable. We found deficiencies in controls, procedures, and data input, as well as a lack of planning for the long-range financial effects of Section 8 contracts.

- Four Moderate Rehabilitation program projects audited in this reporting period will cost HUD $15.7 million more than necessary because of incorrect rents, ineligible units and other noncompliance with regulations.

- The 50 percent default rate in $633 million worth of Title X projects was due in part to a poor insurance commitment process. HUD processing was questionable in 10 of 17 projects audited, including 6 which should not have been approved. The Department had further problems in monitoring, servicing and disposition of projects. Weaknesses included failing to identify projects in trouble and take timely foreclosure and sale actions to minimize losses.

- Single family housing loan origination continued to be plagued with problems regarding down payments, borrower qualifications, property valuation, investor loans, and closing documentation.

- Property disposition branches in Denver, Los Angeles, Houston and New Orleans were reviewed in the wake of the "Robin HUD" scandal. We found their monitoring of closing agents better than in the past, but improvement is still needed.

- Our audits of five insured multifamily projects revealed poor performance by owners/management agents. They allowed substandard housing units, made unauthorized cash withdrawals, charged excessive fees, and incurred other improper and unreasonable expenses.

- The CDBG-funded rehabilitation program was not eliminating health and safety violations in 9 of 12 grantees audited. We attributed this to lack of inspections by grantees and other deficiencies in administering the contracts to rehabilitate low- or moderate-income housing units.

- Subservicing of GNMA's $12.5 billion portfolio of defaulted mortgages takes place with little or no monitoring by HUD. Only one monitoring visit had been made for the 23 subservicing contractors. Selection of the subservicers was also poorly documented by GNMA. We concluded that GNMA has no assurance that subservicers are complying with requirements and acting in the Government's best interest. At one large subservicer, we found weak internal controls, improper expenses charged to HUD, untimely appraisals and inadequate file documentation.

- We conducted two audits of automated systems. We confirmed complaints about the Single Family Insurance Process Enhancement Project (SFIPEP), a contracted computer system revision. Target dates were missed and expected results were not achieved, even though $6 million was spent. In the other audit, computer security procedures at the Department's mainframe facility were found to be weak. The system was vulnerable to unauthorized access because security software was not properly implemented.

MANAGEMENT RESPONSE TO AUDITS

Audit follow-up has improved at HUD. Secretary Kemp and his staff have given it high-level commitment, with Under Secretary DelliBovi designated as the departmental audit follow-up official. While HUD management is primarily responsible for assuring implementation of audit recommendations, we view it as a shared process. To that end, we work daily with the Under Secretary's staff, senior staff, and audit liaison officials.

Of the 886 recommendations without a management decision on April 1, 1990, we reached management decision on 453 by June 1. Of the 1,832 recommendations with management decision but no final action on April 1, there were 212 final actions reported by management in the following 2 months.

A final phase of audit follow-up is corrective action verification. In selected cases, especially those where final action involves implementation of new procedures or methodologies, we visit the auditee to verify that final action was actually consistent with the audit recommendation.

INVESTIGATION

Our investigative efforts in the past 6 months concentrated on continued cooperation in many HUD program areas with US attorneys and the Federal Bureau of Investigation (FBI).

Our close working relationship with the FBI and the Department of Justice (DOJ) spans many years. HUD criminal investigators and auditors are working with DOJ personnel in all 10 regions and are assisting United States Attorneys in obtaining evidence for grand jury testimony and trial preparation. From October 1, 1989 to April 1, 1990, we referred 127 investigations to the FBI and Assistant US Attorneys.

Of special interest to this committee is the Moderate Rehabilitation program area. We currently have a special agent detailed to the investigative team of Judge Arlin Adams, Independent Counsel, and we will soon be assigning additional staff.

In an effort to further enhance our relationship with DOJ, we are planning to hold a joint conference in the fall of 1990 with the FBI. The conference will focus on the need for cooperative efforts to detect, investigate and prosecute fraud in HUD programs. We sponsored similar training last year for approximately 100 investigators and prosecutors from more than 30 cities. This resulted in increased emphasis by the FBI and DOJ in single family mortgage fraud cases. Our upcoming conference will focus on additional programs.

At the present time, we have about 700 investigative cases pending, many of which we are working jointly with the FBI. Our caseload includes both criminal and administrative cases. There are about 200 of our cases pending with U.S. Attorneys. There have been indictments in some of these cases; others are awaiting prosecutive determination. The FBI also has about 650 pending HUD cases, some of which are joint investigations with the OIG.

In addition, we have agents working on task forces with the FBI in such locations as Oklahoma City, Washington DC, Los Angeles, Denver, Seattle and New York.

The Oklahoma Task Force was formed in 1987 and since then 40 persons have been convicted. The government has received $2,874,856 in restitution.

The Goldnet Task Force in Washington DC was formed in 1984. There have been 33 persons convicted, and the Government has recovered over $4.9 million.

SIGNIFICANT INVESTIGATIONS

Chapter 3 of the Semiannual Report describes significant investigations in the past 6 months. The well-publicized frauds by closing agents in the sale of HUD-owned properties were among the more prominent cases. Other noteworthy cases involved loan origination and equity skimming in single family mortgages and fraud by tenants in assisted housing.

In all, there have been seven closing agent prosecutions to date, and nine other cases are in various stages of investigation. Marilyn Harrell pled guilty to embezzling over $5 million and became known as "Robin HUD" because she claimed to have given some of the money to the poor. However, she spent most of the money on personal purposes. She was sentenced last week to 46 months in prison and ordered to pay $600,000 in restitution. HUD contracts with closing agents to handle the sale of properties that HUD acquires after repossessions. In all cases investigated, the closing agents diverted receipts of sales to their own use instead of forwarding the money to HUD. We are working with the Civil Division of the DOJ on each of these matters. Following is a table of cases prosecuted to date.

CLOSING AGENT CASES PROSECUTED

LOCATION	NAME	ESTIMATED EMBEZZLEMENT	STATUS OR SENTENCE
Washington DC	Marilyn Harrell	$5,500,000	46 months prison, $600,000 restitution and community service.
Montgomery AL	Silas Walker	$2,073,499	5 years prison, $2 million fine, $2,073,499 restitution to HUD, $25,000 restitution to IRS.
Arlington TX	Reba Louise Lovell	$2,450,000	6.5 years prison, 5 years probation, 500 hours community service. Civil suit to recover stolen funds is pending.
Indianapolis IN	Lena Stefansson	$384,000	Indicted May 8, 1990. Sentencing scheduled June 29.
Indianapolis IN	Garry Newman (formerly associated with Lena Stefansson)	$54,000	Indicted May 2, 1990. Sentencing scheduled July 25.
Atlanta GA	David, Robert and Teresa Martin	$800,000	Indicted April 26, 1990. Civil suit to recover stolen funds is pending.
Birmingham AL	Bill Fuller	$168,000	5 years probation, $168,000 restitution, 300 hours community service.

Examples of other significant cases during the last 6 months are:

A former mortgage company loan officer in Denver CO was convicted of conspiracy and making false statements in connection with originating 21 loans, 7 of which foreclosed. He was sentenced to 1 year in jail and ordered to pay $50,000 restitution.

Two brothers, who were real estate investors in Philadelphia PA, were convicted of mail fraud, conspiracy and equity skimming involving 50 properties, with a loss to HUD of over $1 million. One brother was sentenced to 5 years in prison and $50,000 restitution. The other was sentenced to 1 year in prison, 5 years probation, and $25,000 restitution.

A rehabilitation specialist in Aurora IL was indicted for embezzling $167,000 of CDBG funds by certifying nonexistent work.

A multifamily project manager from Warren MI embezzled money from six projects. He was sentenced to 4 months of work release, placed on 3 years probation, and ordered to make $600,000 restitution.

An Atlanta, GA contractor was found guilty of attempted bribery after trying to pay $1,500 to a HUD employee for assistance in obtaining contracts and advance notice of government regulations. The contractor was sentenced to 18 months in prison.

A CDBG contractor in Los Angeles CA was convicted for embezzling $65,000 in relocation payments by diverting checks to her personal account. She was sentenced to 6 months in prison, 5 years probation, and restitution of $83,395.

Our office continued to conduct investigations of individuals who defrauded the various housing assistance programs. In the 6-month reporting period, there were 49 individuals indicted, 43 convictions, $464,298 in restitution or repayments, and $79,100 in fines. The most prevalent type of violation involved falsification of documents relating to tenant eligibility so that assistance was improperly received. An example of this type of case concerned a former Section 8 tenant in Boston MA who pled guilty to falsifying income certifications over a 3-year period in which he earned over $106,295. He received $27,000 in Section 8 overpayments.

PREVENTION

In addition to audits and investigations of HUD programs, we have become more active in efforts to prevent fraud and abuse. For example, we play an active role in the Front End Risk Assessment System (FERA). This involves an examination of management controls in all new or substantially modified HUD programs. We believe it is far more economical to implement sound management controls before a new program becomes operational than to correct a flawed program after money has been wasted or lost. FERA has been applied recently in the

Resident Management Program and the Single Family Accounting Management System.

We have also been engaged in two initiatives to prevent and detect tenant fraud--the Tenant Integrity Program (TIP) and income verification computer matching.

TIP consists of workshops to teach PHA staff how to prevent, detect, and take action on tenant error and fraud. We developed the workshop courses and have conducted 23 sessions since last year. Future training will be conducted by the Public Housing Authorities Directors Association and other industry groups. TIP is now being expanded to other HUD-assisted and subsidized housing, such as multifamily projects. Working with professional associations and private contractors, we will instruct trainers and the trainers will conduct workshops. Over 47 workshops have been scheduled.

Computer matching is used to compare wages and unemployment information provided by tenants against information provided by employers. We completed matches in Denver, New Haven and Hartford in the reporting period. We found 316 families who underreported $6.2 million of income and thereby received $1,880,000 in excess rental benefits. In Fort Worth TX, 12 present and former tenants of the PHA were indicted for fraud in connection with allegedly receiving over $109,000 in improper housing payments. The investigation stemmed from a previous computer match. We believe that computer matching should be transferred eventually to HUD program offices for full scale implementation.

HUD STAFFING RESOURCES

Mr. Chairman, you requested that we be prepared today to discuss HUD staffing resources. It is our opinion that HUD staff resources in terms of numbers and expertise are not currently available to deal with the myriad problems facing the Department today. Our opinion is not based on any comprehensive analysis of overall staff needs. Rather, it is based on an historical perspective that spans many years. We attribute many of HUD's current problems to critical staff shortages.

Most of the audits we described in our Semiannual Report are clear examples of problems that relate to staffing needs. For example, in our audit report on the RESC, we disclosed that HUD staff lacked the necessary expertise and training in this unique area. This contributed to the serious problems that the program was experiencing. We reported that an increase in staffing to accommodate HUD's increased property disposition workload as a result of the shutdown of RESC should be a prime consideration of the Department. We also estimated that HUD's underwriting workload could increase by 25 staff years if the Department decides to continue the RESC program and assume its underwriting responsibilities. In either case, enhancement of HUD staff is imperative.

This program with some 190 projects, 82 of which are coinsured, is tiny in comparison to the entire Coinsurance program. However, it does demonstrate the types of staggering problems facing the Assistant Secretary and her staff. Congressional hearings over the past year clearly established that the Coinsurance concept was a dismal failure. The Kemp team took aggressive steps to deal with the failed program prospectively. However, making what we consider to be the right moves created tremendous workload pressures. Housing staff is now faced with the prospects of dealing with the failed lenders and with hundreds of defaulted projects. At the same time, that staff must attempt to maintain an active loan servicing workload to prevent future defaults and begin to prepare for the implementation of a new program to replace Coinsurance.

In the Public and Indian Housing Program area, our recent audit of the PHA Decontrol concept resulted in another situation where making the difficult choice to terminate a program will result in long term benefits to HUD and PHA's. We commend the Assistant Secretary's action. However, the decision's impact over the short term will be staff intensive as a revised program is implemented. PIH staff will be required to develop a set of standards and then proceed with an analysis of all PHA's to determine the degree of compliance with those standards.

Several other audit reports pointed out more traditional problems at HUD. Those problems relate to ineffective staff monitoring of program participants. Monitoring weaknesses were described in the audits of CDBG Program Income and Miscellaneous Revenue, CIAP, and HODAG. The common theme in these reports is that staff was not available in sufficient numbers or qualifications to carry out the monitoring role. Consequently HUD funds were wasted or were used for ineligible purposes.

In responding to the reports, the Assistant Secretaries generally agreed that staffing shortages and skill imbalances contributed to the weaknesses we reported. Competing priorities diverted available staff to other areas. In addition, the Assistant Secretaries pointed out the need for more training to upgrade the staff capability to review rather complex financial transactions.

In summary, our reports over the past 6 months point out some very specific areas where HUD management needs to assure that staff resources (either permanent staff or contractor staff) are assigned to take corrective actions.

While the resource shortages pointed out by our reports are significant, that information pales by comparison with the Department's list of Material Weaknesses under the Federal Managers Financial Integrity Act and the Department's own task forces reviewing 26 financial management areas. Secretary Kemp and Under Secretary DelliBovi have identified HUD's major problem areas through these comprehensive reviews and have begun the process of deciding how best to solve the problems. I believe we are in an excellent position to state that the steps HUD management has taken are unprecedented and probably cannot be overstated. I also believe that it is my responsibility to alert HUD management that past attempts at HUD to do "more with less" have failed.

On a personal note, I would like to point out that a substantial increase in OIG staffing will be required to accomplish the work that remains to be done. Additional positions were approved in the 1990 budget, but as a result of sequestration we were unable to fund these positions. Our 1992 budget requests also reflect staff increases. Our ability to provide vital assistance to the FBI and US attorneys in prosecution of HUD cases is largely dependent upon our success in obtaining these staff increases.

Mr. Chairman, I am optimistic that HUD is going in the right direction. Please be assured that my office stands ready to assist in any way possible to keep the momentum going in that direction.

Thank you for the invitation and I will be happy to answer any questions.

Senator **Graham**. Thank you very much, Mr. Adams.

Mr. Greer, Mr. Neri, did you have any additional comments?

Mr. **Greer**. No, sir.

Mr. **Neri**. No, sir.

Senator **Graham**. Mr. Adams, I have some specific questions for your report, but your opening statement raised a couple of policy questions I'd like to begin with.

One, you have identified several areas of concern that relate to the operation of local Public Housing Authorities. In the recently passed—by the Senate, at least—Affordable Housing Act, some new responsibilities are given to local housing authorities. Under the Secretary's program called HOPE, they will be charged with some new training to try to move towards a more tenant-based management and towards tenant ownership. That's going to require skills that PHA's have not been called upon to have in the past.

Under another provision called the HOP provision there is intended to be greater discretion placed at the local housing authority level in terms of discerning what the problems and needs are in that particular community and greater discretion in allocating resources.

In the debate on that provision, I used the testimony that you largely contributed relative to the Las Vegas Sierra Point project and how we had evidence that if there had been some greater local discretion that maybe the problems that you so effectively outlined would not have occurred.

With that as background, what comments—well, let me add one other element of background:

It seems to me that we have seen some of the most serious problems in HUD occur during periods of transition. For instance, when they were going from the direct insurance to coinsurance, when mod rehab was changing its character, that there has been a pattern of problems within the Department associated with program transitions.

With that addition, what recommendations would you have as to what the Department or the Congress should be doing now relative to Public Housing Authorities at the local level as they are about to undergo a period of transition?

Mr. **Adams**. I have not had an opportunity to review the specific legislation, Mr. Chairman, but let me share with you a couple thoughts that quickly come to mind.

One of those, as I mentioned earlier, the Front End Risk Assessment Program that we have. The Secretary and I both feel very strongly that the more effective way to try to eliminate the problems in the programs is by the early front end review of those programs and trying to install—as those programs are developed and implemented—good controls.

A specific example of that is that we did some audit work about a year ago in connection with the resident management corporation concept and we did a front end risk assessment in connection with that program to assist the Department. We provided about 33 recommendations through our audit.

So I think that effective review of the programs up front and installing proper guidance to the Public Housing Authorities and then holding them accountable is the answer to it.

Senator **Graham**. In terms of the resources which you assess the Department has or which your specific entity within the Department has, are you capable of providing the level of front end risk assessment that you think is appropriate to the task?

Mr. **Adams**. In that particular area we believe we are staffed for that. Our concerns go more to operational auditors and investigators to do the work at the field level that we would need to do.

Senator **Graham**. Let me turn to the second and related question and that is the general subject of staffing within HUD. You made some very effective comments about your assessment.

There is currently before the Congress the budget for the Department for the next fiscal year. If you have had an opportunity to review that, do you have any comments as to whether the budget request, if granted, would bring the Department into a level of staffing in terms of numbers and levels of compensation that would indicate the ability to attract the level of competence and commitment to training that would prepare and re-invigorate the staff for its task?

Mr. **Adams**. That's a very complex question but let me try to respond to at least those portions I feel competent to.

On the general area of compensation, I think the government as a whole is at a very distinct disadvantage at the present time. We find more and more of our seasoned trained employees are leaving to go to the private sector because the compensation is so much greater. And the intangible aspect of that is that Government employees as a whole have been dumped on very severely, if I might use that term, over the past few years I don't think there is any longer any pride in Federal employment. So that those are the two issues as far as the compensation.

On the overall staffing level, I have not done such a review but I think that that's one that cannot be done on raw numbers. Many of those decisions will also have to have related policy decisions as to how the programs will be carried out. Those include whether or not they will be utilizing contractors through delegated processing. Different skill mix and, different numbers that will be needed depending on how programs are carried out and implemented.

Senator **Graham**. Mr. Adams, I'd now like to turn to some specific areas in your report. One of the areas that you focused on was the retirement service centers. Your report states that poor loan underwriting was a major contributing factor to the overall poor performance of the Retirement Service Center Program and, in fact, one of the reasons why the program is experiencing such a current high level of default rate.

Is this poor underwriting a result of inexperienced HUD staff performing this task or is it a lack of monitoring of coinsurers by the Department, some combination, or other factors?

Mr. **Adams**. I believe we'll find that to be a combination, but Mr. Greer, who is accompanying me today, has more specific knowledge and I think is in a better position to comment on the details.

Chris.

Mr. **Greer**. I think there's several factors that go into the problems associated with HUD's experience with retirement service centers. The first one I'd like to mention is that it was a program that was designed within the 221(d)(4) program and put on-line in

1983 with, I think it's safe to say, very, very little preparation on the part of HUD staff and it gets back to something that you mentioned earlier, that HUD simply was not prepared to get off into this area in terms of numbers or expertise.

Senator **Graham**. Mr. Greer, could you describe in a paragraph what were the objectives of the retirement service centers; what was the need that they were intended to meet?

Mr. **Greer**. Apparently, the way we understand it, industry came to the Department saying there was this market that was beginning to form and would be continuing to form over the next several years as the population got elderly and that there were many, many families or individuals that needed housing with some amenities, i.e., dining facilities or things like that. These are individuals that don't necessarily need nursing care or anything like that but needed a place to go after they retired and maybe had lost a spouse or something like that.

They came to the Department and said there's a growing market for this and we need to start underwriting loans in this area. And that was the basic premise for HUD getting involved in the program. However, when HUD did that, they did it administratively, as I mentioned earlier: they just slipped the program into the 221(d)(4) program.

Then along in about 1985 they compounded the inexperience problem and the lack of guidance and training for HUD staff by allowing these retirement service centers to be coinsured, as were the 223(f) and the regular 221(d)(4) projects.

So now you had a situation where HUD had both full insurance and now you had co-insured lenders doing the underwriting of those loans and the skills that you need to monitor a co-insured lender are not necessarily the skills you need to underwrite a loan, but the bottom line was that HUD had none of those skills and the workload was just too much. And that really contributed to a lot of the problems. In many cases, the markets simply didn't form and the economic conditions weren't right for these things to be successful.

I guess the easiest way to phrase it, it was a program several years ahead of its time probably and was a bad decision on HUD's policymakers at that time to start this program without being prepared up front.

Senator **Graham**. In some of the other programs that were initiated at about the same time there subsequently were allegations of political influence. Did you detect any of that as part of the initial decision to establish this program or in the implementation of the program?

Mr. **Greer**. I think you're referring to the Mod Rehab Program which—in our reports we stated that we thought the regulations in the Mod Rehab Program were fairly straightforward and simply were bypassed by several individuals at the Department at that time.

More directly, all of this stuff that's come out over the last year about the political influence peddling, that was simply people bypassing the regulations.

Senator **Graham**. Did you find any similar pattern in the Retirement Service Centers Program?

Mr. **Greer**. There were a couple of occasions that we became aware of, not necessarily through our audit work but we do cite in our audit report situations where the regional or the field offices, in doing their economic market analyses, would say that that project probably should not go forward.

On several occasions either the lender or the sponsor of that project appealed those decisions to headquarters and, in those situations, oftentimes headquarters overruled the field and did, in fact, approve those projects.

In reviewing the docket files that we had available at HUD, we found no specific indications of political influence. However, when the scandals broke last summer, several news accounts reported instances where consultants had in fact been paid to obtain those waivers.

And I might add that you really don't find any of the information that we found in the mod rehab thing either through going through HUD files. It's through a series of interviews and talking to various individuals that you find those things out.

Senator **Graham**. Have you done the series of interviews for the retirement service centers proportionate to those that you did in mod rehab?

Mr. **Greer**. No, sir, we didn't explore that to any great extent.

Senator **Graham**. Apparently there were in your report about 10 projects that had been rejected at the regional or field level and were subsequently reversed at the headquarters level with limited or no reason given as to why that reversal took place. Of those 10 retirement service center projects, all are now in some level of financial problem.

Do you plan on doing any further investigation into those projects where there was an unexplained reversal of decisions?

Mr. **Greer**. I'm not sure if we'll look at the individual projects. Our whole purpose usually in doing a review of this type is to attempt—as Paul said earlier, we're always looking back at situations and our objective is to make prospective improvements. I think that would be my response in this case.

We believe that the situation that HUD has allowed itself to get into, that is, allowing this appeal process and—although there probably are some situations where an appeal is necessary, during this period of time we think that that situation was used too often.

I believe the current administration's philosophy is to allow the field managers, those people that are responsible for making decisions, in fact, make those decisions without a great deal of this type of thing going on. We certainly would support that.

There are a couple of specific situations that have been passed on to the investigative side of the house and will be explored, but I don't think that we as auditors intend to go back and look at all ten of those situations. I think we commented on four that we did look at.

Mr. **Adams**. Mr. Chairman, I believe the 10 you referred to are in the title X program rather the retirement service—Mr. Greer corrects me I'm wrong also.

Okay. My apologies. I thought that was——

Mr. **Greer**. Ten projects in the retirement service centers.

Senator **Graham**. Turning to another subject, the housing development corporations, in auditing the relationship between public housing authorities and housing development corporations, your report discusses an incident whereby a housing development corporation pledged the assets of the public housing authority for collateral in developing a tax syndication deal, thus placing Federal monies at risk if the project should fail.

Could you give us some further description of this incident and tell us of others like this where Federal money was put potentially at risk?

Mr. **Adams**. I believe that occurred in Pueblo, Colorado and I'm not sure that we're aware of any other instances of that, Mr. Chairman, but Mr. Greer will provide the details on that.

Mr. **Greer**. That audit was done on in our region 8 location which is Denver and—or Colorado and the surrounding States. We looked at 23 PHA's I believe and found this one instance where in order to go forward with a tax syndication deal the people involved in that asked and received an indemnification agreement from the public housing agency that if in fact there was a problem with a tax syndication deal tha' the syndicator could come back to the public housing agency and receive some remuneration and that remuneration was the assets of the public housing authority that was pledged as the payment for the agreement—with that indemnification agreement.

I know that sounds a little convoluted, but it's that type of situation that we think needs to be looked at and regulated, perhaps.

Senator **Graham**. Under what legal authority could the PHA pledge its assets to a private venture?

Mr. **Greer**. They have no legal authority to do that.

One of the things we recommended in our report is that there be a legal analysis of the relationships. Towards the end of May we obtained a copy of a response from the Office of Public and Indian Housing to Under Secretary DelliBovi which states basically that the staff at Public and Indian Housing feels that perhaps the regulations are there, they simply need to be enforced and they agree that guidance has to be provided to the staff and to public housing agencies but perhaps that the teeth is already there in the regulations. So I guess it will depend on what happens in the future as to how we look at this whole situation.

Senator **Graham**. Turning to title X, you identified some use of consultants in the title X program that were reminiscent of what we heard earlier in the Mod Rehab Program.

Could you elaborate on the instances that you cite on the influence of consultants in the title X program?

Mr. **Adams**. Once again I'd like to turn to Mr. Greer to provide that detail, sir.

Mr. **Greer**. In our title X report I believe we commented on 6 instances where we felt that the bottom line decision was made perhaps based on some relationship other than what we consider a normal relationship.

The title X program again is a very complex program and we believe——

Senator **Graham**. Could you—Excuse me, Mr. Greer, but again in a paragraph could you summarize the title X program, what its objectives are and who it serves?

Mr. **Greer**. The basic premise of the title X program was to develop raw land into lots that would be ready and available for building houses. Part of that housing was supposed to be for low- and moderate-income people. And it was a mortgage insurance program. Basically it was developing raw land, getting it prepared to build houses on, putting in the infrastructure and that type of thing.

Senator **Graham**. And what was the nature of the use of consultants in this program?

Mr. **Greer**. Because land development is a rather complex area, we believe there probably is a need for consultants to prepare, you know, plans and specifications in dealing with all the complex situations. However, the occasions that we cited were individuals not doing that type of consulting but, rather, we believe the so-called influence peddling type of occasions. In other words, simply getting the officials in HUD to approve the project.

We cited that condition in 6 specific projects that we felt in our judgment probably should not have been approved but were. And again, those situations have been referred to our office of investigation and, I believe, on to the other authorities for review.

Senator **Graham**. In the Mod Rehab Program, the inference was that consultants who, in many cases, had had a previous employment relationship within HUD or had a personal relationship with persons currently in HUD were able to use their influence to achieve a positive or expedited decision on their request for funding.

Is that essentially the pattern that you saw and, if so, were there any of the same personalities that were identified in mod rehab that were also involved in title X?

Mr. **Greer**. There are indications that some former HUD officials were involved in these programs, former assistant secretaries. There are also indications that some of the non-former HUD officials who had been involved in other HUD programs including Mod Rehab were also doing business in the title X program.

Senator **Graham**. What you have just discussed relative to each of these programs, retirement service centers, PHA's and their affiliated housing development corporations and now title X will be significant areas for monitoring of the current management of the Department in terms of effective steps to redeem these problem programs, as well as the potential for continued oversight by the Congress to better understand how these programs have been subject to abuse. And I appreciate your bringing these to our attention.

Mr. **Adams**. I would like to comment on one thing, Mr. Chairman. The title X program is a perfect example of a program that's been terminated but it still has certain aspects that need to be addressed prospectively to dispose of those properties and to process those existing loans that are out there. So there will be a continuing need for staffing and oversight by us. Although the program has actually been terminated, it has a life of its own and it goes on even after termination.

So I think that's one of the things that we often lose sight of is that when a program terminates we kind of assume that there is no longer a need for attention and staffing to be provided to that program. But it has a life of its own and it will go on for several years.

Senator GRAHAM. There's another consequence of termination and that is that there generally was some credible reason why these programs were established in the first place, there was a credible reason for mod rehab, the desire to bring into the housing stock homes which did not meet building standards at the time but which, with a modest investment, could be brought up to standards.

I don't know much about the title X program but I assume there was some rationale to the feeling that there was a role for the Department in terms of land preparation as a necessary prerequisite for the construction of housing for low- and moderate-income families.

If the title X program is now terminated, is that an indication that there was no need in the first instance or that the need which existed has evaporated or that some alternative program has been initiated in order to meet the continuing need.

Mr. ADAMS. It's my understanding that the decision in large part was made because it was not achieving one of its primary goals and that was to provide housing for low- and moderate-income. It was all upscale middle- and upper-income housing that was being provided. So it was a policy decision.

Senator GRAHAM. Mr. Adams, thank you very much for very helpful insight as always. I appreciate the many times that you have assisted us during the course of this subcommittee's hearings and thank you very much for your service to the Congress, to the Department and to the American people.

Mr. Adams. Thank you, sir.

Senator GRAHAM. Mr. DelliBovi.

[Pause.]

Good morning, Mr. DelliBovi.

Mr. DELLIBOVI. Good morning, Mr. Chairman.

Senator GRAHAM. I also wish to welcome you and express how appreciative I am, as well as the members of the committee and our staff, for your very fine cooperation and assistance throughout the work of this Subcommittee.

STATEMENT OF ALFRED DELLIBOVI, UNDER SECRETARY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, ACCOMPANIED BY LLOYD CHAISSON, SENIOR ADVISOR

Mr. DELLIBOVI. Well thank you, Mr. Chairman, and members of the subcommittee. I appreciate this opportunity to appear again before you. With me is Lloyd Chaisson, who is a senior advisor to me as the Under Secretary. And we're pleased to appear before you today to discuss Secretary Kemp's second semi-annual management report, our actions to settle the backlog of Inspector General audits and our efforts to correct the systemic problems which left many HUD programs prone to waste, fraud and abuse.

The entire process of HUD reform did not begin with this semiannual report. Upon his arrival at HUD, Secretary Kemp asked the Inspector General to brief him on all open audits and investigations within the Department. Secretary Kemp has since been deeply involved at every step of the way. This report describes Secretary Kemp's efforts between October 1, 1989 and March 31, 1990, to improve HUD's audit resolution and follow-up process.

Mr. Chairman, through steadfast effort these past six months, we have cleared a staggering backlog of open audit recommendations. We have made management decisions on 95 percent of all audits in the pipeline as of October 1, 1989. We took final action on 390 audits, or 45 percent of all the audits during the reporting period.

Under Jack Kemp's stewardship we have made considerable progress in strengthening and improving financial and management controls over many HUD programs that were abused in the past. Secretary Kemp has likened our efforts to reform HUD to a marathon rather than a sprint. This report is an indication of the considerable progress we have already made. It is also an indication of the distance we must cover in the months ahead.

While we continue to make progress, it has become apparent to us that we also need to give greater scrutiny to audits to ensure that fixes are positive and lasting. As you know, Mr. Chairman, generally HUD audits describe deficiencies in program design and management. Often these deficiencies center on three very important organizational elements: staffing, monitoring and training. Deficiencies in one or more of these areas are often cited as apparent root causes of problems and recommendations are made to increase the quantity of each: more staff, more monitoring, more training. Sometimes this formula approach works and additional inputs make the system run better. But what if the system is flawed? Can this approach solve fundamentally flawed programs?

Mr. Chairman, my experience as HUD's Chief Operating Officer has clearly revealed to me that HUD's problems are not necessarily caused by inadequate resources, despite what many may say and think. We do not see HUD's problems as strictly input driven. And when I say "input," I mean staff and budget expense dollars. We are, instead, examining outputs and asking fundamental questions about the products we deliver and the markets we serve.

I would like to provide the committee with HUD management's perspective on each of these program inputs and perhaps a better way to determine exactly how to arrive at corrective actions that work, are sustainable and are measured by the level and quality of service provided to the most needy—not to the developers, the consultants or the poverticians.

Staffing, first; let me address this issue.

Inadequate staffing at HUD has been an underlying hypothesis of these hearings and our meetings with your staff. We generally do not advocate more staff unless it can be conclusively proven that we need more staff. The mere assertion that work is not completed on time or done correctly does not automatically translate into a need for more staff. Now this statement may sound paradoxical. But if solutions were always obvious, perhaps HUD would not have experienced the fraud, waste and mismanagement of prior years.

If we followed the prescriptive input approach, we might simply treat symptoms and not root causes. We would overload a system that has very little absorption capacity. While many might be happy that additional resources were added to the system, I can assure the committee that little would change. Putting resources into flawed systems only serves to exacerbate problems.

The primary goal of the Kemp team is to redesign these flawed systems and only then establish the staffing requirement, with a strong bias toward quality not quantity.

We have initiated such an in-depth review of our housing programs and are asking essentially three questions: First, what is the market we should serve? Second, are we delivering the right product to meet market requirements? And third, is our delivery mechanism properly configured in terms of staff, skills, systems and budget?

Monitoring is another area that is frequently cited as needing reform. Monitoring is fine if you monitor the right things and then act on your findings. I always tell HUD staff that they should look at monitoring as compliance enforcement.

However, monitoring implies checking for quality. It is a quality control mechanism to ensure that our machinery is producing our product to specification. Programs that warrant significant and continuous monitoring are likely high-risk programs in need of reform. Again, the magnitude and frequency of monitoring as a recommendation is often symptomatic of a flawed program. It is indicative of a product or a program that cannot be consistently manufactured or delivered to specification.

Secretary Kemp recognizes that after the fact treatment of symptoms is an inefficient scheme. As a result, he has initiated an activity with the Inspector General to assess risk at the front-end of our program design process. The idea is very simple: we want to design quality into our programs rather than monitor it in after the fact.

Training. On the issue of inadequate training, I would agree that our skill base at HUD is not what it should be. We are working on this and have initiated several efforts to restore the necessary skills to the Department at all organizational levels. The committee should know, however, that this is not an overnight fix. It takes time. But the payoff will be a lasting set of Departmental capabilities that will not erode over time.

Secretary Kemp recently announced a management-intern initiative to bring fresh talent into our entry- and mid-level staffs. We have started a major recruiting effort in housing, particularly the multifamily area, to recruit the necessary skilled professionals to help us do a better job in our insurance and subsidy programs.

I would like to emphasize to the committee that it is important to think in terms of outputs rather than inputs. Staffing, monitoring and training are inputs. The question should be what are the American taxpayers receiving for their tax dollar? Presumably we should be serving low- and moderate-income populations in the most effective and efficient manner possible. That means that each dollar spent on assistance goes to the most needy in the most efficient manner possible. That is what I mean when I say output. That is the real measure of success, not how many dollars we spend or how many people we hire or train.

As I prepared for this testimony today, it occurred to me that examples taken from real-life situations might serve to illustrate these points. So let me focus on two examples that arose from significant Inspector General audits and the actions that HUD is taking to address the problems those audits identified.

One week ago today, Marilyn Harrell, the former Maryland real estate agent known as "Robin HUD" was sentenced to a maximum prison term. While the sentencing closes her case, as HUD examines the entire issue of FHA closing agents, we must not pose the question, we must answer the question, Can this happen again?

The Department has reacted swiftly with a series of measures to ensure that closing agents cannot defraud or embezzle from the government with impunity or without fear of detection. Safeguarding HUD's closing agent system has been one of the Secretary's priorities and has received his full attention. We have made it perfectly clear that accountability will be the watch word.

Three major problems arose around the issue of closing agents: No. 1, there was little or no monitoring of closing agent activity and no verification through the Department's accounting system. No. 2, there were no clear reporting lines between offices and there was a general lack of accountability. And No. 3, the standards of qualifications for the closing agents were inadequate.

To address those problems we have taken the following steps:

Our field offices will review daily reports on money receipts from closings. We have revised the wire transfer forms to reduce the possibility of error. Closing agents are now required to submit weekly reports detailing the status of closings they are handling for HUD. For all new contracts, the Department will require closing agents to maintain a bond in the amount of two month's worth of closings. We will not renew current contracts for non-bonded agents and we have instructed our field offices to contract through Requests for Proposals that emphasize the bidder's ability to perform duties effectively and efficiently, rather than just going for the lowest bid.

Through prudent management reforms, HUD has been able to tighten the internal controls and with continued improvements turn around a program that was fraught with abuse.

The second example I'd like to talk about is retirement service centers. That is because there are some programs which are so fundamentally flawed that they are doomed for failure no matter the size of the staff nor the hours spent monitoring the program.

The Retirement Service Center Program is an example of such a doomed program. It was a program that was developed to meet a perceived market need of luxury residences for upper-income retirees. I say "perceived market need" because even for upper-income projects it is a very risky endeavor.

In response to growing losses, the Secretary placed a moratorium on the Retirement Service Center Program on July 6, 1989. Then we requested that our Office of Policy, Development and Research undertake an evaluation of this program. PD&R has now completed its evaluation and has made the following major findings:

No. 1, there is limited demand for the program.

No. 2, the Retirement Service program is not actuarily sound. 29 percent of the insured projects are in default and another 23 percent are in financial trouble.

No. 3, Retirement Service Centers cannot serve low- and moderate-income elderly people.

And No. 4, other options are available to provide housing assistance and support services to the low-income elderly.

HUD estimates that the present value of the net loss to the FHA general fund from the retirement service center projects could range up to $291 million. This combines losses from both the full insurance and the coinsured retirement service centers.

Taking the worst-case scenario, the losses represent an unfortunate missed opportunity to provide for the needs of low-income elderly persons. The $291 million could have been used to provide housing and services to 9,900 households for 5 years under the HOPE supportive services for the frail elderly proposal which the Senate passed earlier this week.

Based on these findings, we have decided to terminate the program. The Department will develop an operating plan for reviewing troubled projects and for the efficient disposition of the foreclosed projects.

Mr. Chairman, I compliment you and the subcommittee staff for the objective, thoughtful, positive and progressive way in which you have gone through HUD's problems with an eye on lasting reform, systemic reform and political reform.

We have made substantial progress. While HUD is strong, we intend to do all that is necessary in cooperation with the Congress to ensure that the reform efforts we started over a year ago are completed and to seek continuous management improvements in the future.

As we work to carry out HUD's mission, we must all keep in mind that government should be judged like every other enterprise in our society: on the results and the outputs delivered, not simply the dollars appropriated and spent.

President Bush and Secretary Kemp are confident that with the bipartisan support of Congress we can keep HUD in the business of helping Americans in need achieve their dreams of home ownership, jobs, in an environment of social and economic opportunity in which to raise their families.

Thank you very much. I will be pleased to answer any questions.

[The complete statement of Alfred A. DelliBovi follows:]

TESTIMONY OF ALFRED A. DELLIBOVI
AT THE HUD/MOD REHAB
INVESTIGATIVE SUBCOMMITTEE OF THE SENATE COMMITTEE

INTRODUCTION

Mr. Chairman and members of the subcommittee, I appreciate this opportunity to appear before you to discuss Secretary Kemp's second Semi-annual Management Report; our actions to settle the backlog of Inspector General audits; and our efforts to correct the systemic problems which left many HUD programs prone to waste, fraud and abuse.

The entire process of HUD reform did not begin with this semi-annual report. Upon his arrival at HUD, Secretary Kemp asked the Inspector General to brief him on all open audits and investigations within the Department. Secretary Kemp has since been deeply involved at every step of the way. This report describes Secretary Kemp's efforts between October 1, 1989, and March 31, 1990, to improve HUD's audit resolution and follow-up process. Mr. Chairman, through steadfast effort these past six months, we have cleared a staggering backlog of open audit recommendations. We made management decisions on 95 percent of all audits in the pipeline as of October 1, 1989. We took final action on 390 audits, or 45 percent of all audits during the reporting period. Under Jack Kemp's stewardship we have made considerable progress in strengthening and improving financial and management controls over many HUD programs that were abused in the past. Secretary Kemp has likened our efforts to reform HUD to a marathon rather than a sprint. This report is an indication of the considerable progress we have already made. It is also an indication of the distance we must cover in the months ahead.

While we continue to make progress, it has become apparent to us that we also need to give greater scrutiny to audits to ensure that fixes are positive and lasting. As you know Mr. Chairman, generally HUD audits describe deficiencies in program design and management. Often these deficiencies center on three very important organizational elements:--staffing, monitoring, and training. Deficiencies in one or more of these areas are often cited as apparent root causes of problems and recommendations are made to increase the quantity of each:--more staff... more monitoring... more training. Sometimes this formula approach works and additional inputs make the system run better. But what if the system is flawed? Can this approach solve fundamentally flawed programs?

Mr. Chairman, my experience as HUD's Chief Operating Officer has clearly revealed to me that HUD's problems are not necessarily caused by inadequate resources despite what many may say and think. We do not see HUD's problems as strictly input driven. When I say input, I mean staff and budget expense dollars. We are examining outputs and asking fundamental questions about the products we deliver and the markets we serve. I would like to provide the committee with HUD management's perspective on each of these program inputs, and perhaps a better way to determine exactly how to arrive at corrective actions that work, are sustainable, and are measured by the level and quality of service provided to the most needy... not the developers, consultants, or poverticians.

STAFFING

First, let me address the issue of staffing. Inadequate staffing at HUD has been an underlying hypothesis of these hearings and meetings with committee staff. We generally do not advocate more staff unless it can be conclusively proven that we need more staf. The mere assertion that work is not completed on time or done correctly does not automatically translate into a need for more staff. This statement may sound paradoxical. But then if solutions were always obvious, perhaps HUD would not have experienced the fraud, waste, and mismanagement of prior years.

If we followed the prescriptive "input" approach, we might simply treat symptoms and not root causes. We would overload a system that has very little absorption capacity. While many might be happy that additional resources were added to the system, I can assure the committee that little would change. Putting resources into flawed systems only serves to exacerbate problems. The primary goal of the Kemp team is to redesign these flawed systems and only then establish the staffing requirement, with a strong bias toward quality, not quantity. We have initiated such an indepth review of our housing programs and are asking essentially three questions. First, what is the market we should serve? Second, are we delivering the right product to meet market requirements? Third, is our delivery mechanism properly configured in terms of staff, skills, systems, and budget?

MONITORING

Monitoring is another area that is frequently cited as needing reform. Monitoring is fine if you monitor the right things and then act on your findings. I always tell HUD staff that they should look at monitoring as compliance enforcement.

However, monitoring implies checking for quality... it is a quality control mechanism to ensure that our machinery is producing our product to specification. Programs that warrant significant and continuous monitoring are likely high risk programs in need of reform. Again the magnitude and frequency of monitoring as a recommendation is often symptomatic of a flawed program. It is indicative of a product, or program that cannot be consistently manufactured to specification. Secretary Kemp recognizes that "after the fact" treatment of symptoms is an inefficient scheme. As a result, he has initiated an activity with the Inspector General to assess risk at the front end of our program design process. The idea is simple... we want to "design" quality into our programs rather than "monitor" it in.

TRAINING

On the issue of inadequate training, I would agree that our skill base at HUD is not what it should be. We are working on this and have initiated several efforts to restore the necessary skills to the Department at all organizational levels. The committee should know, however, that this is not an overnight fix. It takes time, but the payoff will be a lasting set of Departmental capabilities that will not erode over time.

Secretary Kemp recently announced a management intern initiative to bring fresh talent into our entry and mid-level staffs. We have started a major recruiting effort in Housing-- particularly multifamily--to recruit the necessary skilled professionals to help us do a better job in our insurance and subsidy programs.

I would like to emphasize to the committee that it is important to think in terms of outputs, rather than inputs. Staffing, monitoring, and training are inputs. The question should be what are the American taxpayers receiving for their tax dollar? Presumably we should be serving low- and moderate-income populations in the most effective and efficient manner possible. That means each dollar spent on assistance goes to the most needy in the most efficient manner possible. That is what I mean when I say output. That is the real measure of success, not how many dollars we spend or how many people we hire.

As I prepared for this testimony today, it occurred to me that examples taken from real-life situations might serve to illustrate my points. Let me focus now on two examples that arose from significant Inspector General audits and the actions HUD is taking to address the problems identified.

FHA CLOSING AGENTS

One week ago today, Marilyn Harrell, the former Maryland real estate agent known as "Robin HUD," was sentenced to a maximum prison term. While the sentencing closes her case, as HUD examines the entire issue of FHA closing agents we must not pose the question, we must answer the question, "Can this happen again?" The Department has reacted swiftly with a series of measures to ensure that closing agents cannot defraud or embezzle from the government with impunity or without fear of detection. Safeguarding HUD's closing agent system has been one of the Secretary's priorities and has received his full attention. We have made it perfectly clear that accountability will be the watchword. Three major problems arose around the issue of closing agents: (1) there was little or no monitoring of closing agent activity and no verification through the Department's accounting system; (2) there were no clear reporting lines between offices and a general lack of accountability; and (3) the standards of qualifications for closing agents were inadequate.

To address those problems, we have taken the following steps. Our field offices will review daily reports on money receipts from closings. We have revised the wire transfer forms to reduce the possibility of error. Closing agents are now required to submit weekly reports detailing the status of closings they are handling for the Department. For all new contracts, the Department will require closing agents to maintain a bond in the amount of two month's worth of closings. We will not renew current contracts for non bonded agents and we have instructed our field offices to contract through Requests for Proposals that emphasize bidder's ability to perform duties effectively and efficiently, rather than going just for the lowest bid.

Through prudent management reforms, HUD has been able to tighten the internal controls and with continued improvements turn-around a program that was fraught with abuse.

RETIREMENT SERVICE CENTERS

However, there are some programs that are so fundamentally flawed that they are doomed for failure no matter the size of the staff nor the hours spent monitoring the program. The Retirement Service Center program is an example. It was a program that was developed to meet a perceived market needs of luxury residences for upper-income retirees. I say perceived market needs because even for upper-income projects it is a very risky endeavor.

In response to growing losses, the Secretary placed a moratorium on the Retirement Service Center program on July 6, 1989. Then, we requested that our Office of Policy, Development and Research undertake an evaluation of this program. PD&R has now completed its evaluation and has made the following major findings:

- there is limited demand for the program;
- the Retirement Service Center program is not actuarially sound -- 29 percent of the insured projects are in default and another 23 percent are in financial trouble;
- ReSCs cannot serve low- and moderate-income elderly; and
- other options are available to provide housing assistance and support services to low income elderly.

HUD estimates that the present value of the net loss to the FHA General Fund from retirement service center projects could range up to $291 million. This combines losses from both full insurance and coinsurance. Taking the worst case scenario, the losses represent an unfortunate missed opportunity to provide for the needs of low income elderly persons. The $291 million could have been used to provide housing and services to 9,900 households for 5 years under the HOPE supportive services for the frail elderly proposal.

Based on these findings, we have decided to terminate the program. The Department will develop on operating plan for reviewing troubled projects and for the efficient disposition of foreclosed projects.

CONCLUSION

Mr. Chairman, Senator Mack, I compliment you and the subcommittee staff for the objective, thoughtful, positive, and progressive way in which you have gone through HUD's problems, with an eye on lasting reform, systemic reform, and political reform. We've made substantial progress. While HUD is strong, we intend to do all that is necessary in cooperation with Congress, to ensure that the reform efforts we started over a year ago are completed and to seek continuous management improvements in the future.

As we work to carry out HUD's mission, we must all keep in mind that government should be judged like all other enterprises in our society: on the results and outputs delivered, not simply the dollars appropriated and spent.

President Bush and Secretary Kemp are confident that with the bi-partisan support of Congress, we can keep HUD in the business of helping Americans in need achieve their dreams of homeownership, jobs, in an environment of social and economic opportunity in which to raise their families.

Thank you.

Senator GRAHAM. Thank you very much, Mr. DelliBovi, and I would like to say I concur in your analytical approach, that the relevant questions are output performance questions rather than input. Those are tactics to accomplish an objective, not the objective itself.

And in that regard, I think it's important, as we evaluate existing programs and particularly in the initiation of new programs, to have a clear understanding of what are the performance standards by which we are prepared to be judged.

Having said that regarding the new HOPE program of the Department, what will be the three or four or more most significant performance indicators that the Department will be monitoring as an on-going assessment of the effectiveness of that new program?

Mr. DELLIBOVI. First, defining the target population and measuring whether we reach that target population. Second, do we reach them with the maximum benefits, the maximum efficiency in terms of the delivery, the pass-through of the benefits.

For the HOPE program, which is designed to promote homeownership, we want to be judged on the additional number of low- and moderate-income Americans who we put into homeownership.

On the homeless programs, we want to be judged on the number of families and individuals who receive a total program of care, not just the roof over their head but the other social services that will enable them to put their lives together.

As we develop these programs, each and every one of them is going to be designed and measured so that performance is taken into consideration in terms of dollars spent and individuals benefitted. We are in the business of helping people. The end of the pipeline is what we want to look at.

Senator GRAHAM. Accepting that, what are the databases that you're going to be monitoring that you will look to to help answer the question of whether you're accomplishing that objective?

Mr. DELLIBOVI. Well we will start with the basic census data in each of the areas being served—we will have the benefit of the 1990 census—to begin with. We also will be able to measure the number of families or individuals that benefit from these programs.

We have, under the reform legislation that was passed last year, been given the authority for the first time to have an on-going monitoring and evaluation program at the Department, measuring how well our programs perform.

We have sought from the Appropriations Committees in the 1991 budget process the funds to carry out that monitoring and evaluation. The committees have not yet done their work. We have met with the staff and the leadership of both committees on both sides and we are encouraged that we will be given the resources we need to measure that performance. Assuming we get it, we will accomplish that task.

Senator GRAHAM. I am a strong believer in both the philosophy of performance management and also evaluating that management by numbers. And I think that it is important that there be an understanding between the Department and the Congress as to how each of us are going to be evaluating the achievement of our performance objectives.

So I would like to ask maybe for supplementation if you could indicate with some greater specificity what number of families you intend to serve, what will be the indicators that you have provided them the full array of necessary services in addition to shelter, factors such as how many of those individuals are able to move from subsidized to unsubsidized housing to achieve levels of training skills, employment, the educational performance of their children or other indicators of impact on their personal and family lives?

I would assume those would be the kinds of quantitative indicators that the Department would be monitoring, is that correct?

Mr. DELLIBOVI. That is correct and it is our intention to develop for each of the programs when the final legislation passes a business plan which will lay out those facts as well as lead us to the implementation structure for the new program.

I would ask that we be allowed to submit those plans after the legislation has been enacted since they will not be developed beforehand. We'll be happy to work with the staff on some models assuming a sample of those programs are enacted, but we are not going to begin developing the business plans for all of the programs until we know exactly which ones have been authorized and how.

Senator GRAHAM. But in your initial architectural design——

Mr. DELLIBOVI. Yes.

Senator GRAHAM [continuing]. Before you submitted these plans to the craftsmen of the Congress to build into a final legislative house, you had some ideas of what it was you were trying to accomplish and how you——

Mr. DELLIBOVI. Yes, we do and we'll be pleased to submit that for the record.

Senator GRAHAM. That's what I—I'm trying to get in a sequential form your analysis of how you propose to implement in a specific context this new performance directed orientation.

Mr. DELLIBOVI. OK.

Senator GRAHAM. And I will restate that I am personally very supportive of that approach and hope that Congress will be a fully ally in that orientation towards how the American public fulfills its responsibility to housing those Americans who look to the Federal Government for assistance in that.

Mr. DELLIBOVI. Sure.

Senator GRAHAM. Mr. Dellibovi, I'd like to now turn to some more specific questions that arise largely from the Inspector General report. The principal focus of your appearance here today is in response to the latest semiannual report of the Inspector General.

One of the issues that you have already discussed is the question of staffing and monitoring. In the IG's report on page 28 it is stated that FHA operates 47 different insurance programs and has $300 billion of insurance in force, yet it currently has only one certified actuary.

I wonder if you could comment as to what the Department's plans are and whether they consider that to be an area of staffing deficiency?

Mr. DELLIBOVI. The Secretary has said repeatedly that the fact that FHA has only one actuary is a defect. We are looking at expanding our actuarial capacity, either by hiring additional staff—and I think that's one area where we probably will—but also being able to have on a contract basis additional actuarial expertise available to the FHA.

I would also point out that one of the reasons that the FHA has only one actuary is because there's been no focus on actuarial data in the management of FHA, and that's dramatized by the single family study that was recently completed by Price Waterhouse. As you know this—it's only in the last year that we've even been able to audit the FHA single family insurance fund. The other funds are still in such dreadful shape that they cannot be audited and if you couldn't do a basic audit you couldn't even begin to do an actuarial study. So as we focus on the need to have actuarial soundness in these programs, we will build up our actuarial expertise and capability.

Senator GRAHAM. Another area that the Inspector General's report discusses in terms of staffing is the Housing Development Action Grants, HODAG. He states that due to inadequate monitoring only eight of the 249 contracts of HODAG were settled in fiscal year 1989. He states further that HODAG settlements are assigned to the same staff that have other high priority workloads including determination of the coinsurance program.

Have you looked at that area in terms of need for additional either quantity and/or quality of staffing?

Mr. DELLIBOVI. Yes, we have. And clearly multifamily housing, as indicated in my prepared testimony with reference to the internship program is one area where we need more staff and better trained staff.

Multifamily has become an area at HUD in the FHA which is like the narrowest point in the funnel. And there is too much work falling on too few people in that area. We are out hiring additional people for that area and also looking at farming out some of the work to other parts of the FHA so that those problems can be dealt with effectively.

We have issued two directives specifically to our field offices and industry groups that are designed to eliminate the equity skimming and double damage payments that were cited in the audits and we are currently reviewing the IG's final report on this program. I believe this week we're going to send a response to the IG. I don't have that response here today, but we are responding.

Senator GRAHAM. You spoke in your prepared statement about the fact that you don't immediately assume the way to solve a problem is by adding inputs but rather to look at the structure of the program and evaluate its performance and see if there are other ways by institutional systemic changes or qualitative changes to improve its performance.

Is HODAG a program that you have done any analysis towards that method of remediation?

Mr. DELLIBOVI. Well Mr. Chairman I would say generally that the monitoring process at HUD is being reviewed to see what it is that our staff is out monitoring and to check to make sure that the questions we ask, the things that we look for as we monitor a program are on target to the performance we expect.

I have found in too many cases we are monitoring the wrong thing. It's maybe a useful bit of information to collect these facts, but it is not as useful as looking at something else could be. And

HODAG is certainly an example of that. There was monitoring going on. It just didn't catch the right things. It wasn't focused at the vulnerabilities.

And when I say monitoring should be related to enforcement, I mean that monitoring should attempt to uncover areas where the program is not being delivered, where the rules and regulations are not being followed, and that impacts who receives the service and who doesn't receive the service.

Perhaps I can use an example from outside the world of HUD and say that a bank might measure what goes on in one of its branches by the amount of deposits or the amount of deposit slips that are used in the bank. I suspect most bankers watch the amount of deposits that they get; although they might be alarmed if that varied from the deposit tickets.

At HUD we tend to be in many of these programs counting forms. It might be useful information to whoever has to order the forms, but that shouldn't be the focus of a monitoring team.

I would also note that for each of our programs we are doing a full program analysis, which we call a program planning guide, to examine how the program operates and try and give a fresh look as to what is happening here.

In some cases, this has been the first time there has been such an operational review of these programs almost since their inception. Many of these programs evolved during the New Deal. They're good programs, and their procedures may have been good in 1936, but we've moved on, and the programs can still be good with new, improved procedures.

We often are using data processing, personal computers, and advanced computers that didn't exist in the 1930's. But if they're not integrated to a total system, and they're not at HUD unfortunately, they still function like shoe boxes with all these little slips of paper. I mean, they're fancy shoe boxes; they're expensive shoe boxes; but basically they are no more useful than slips of paper in a shoe box.

Senator GRAHAM. I applaud you on that performance review process. I would suggest that a first threshold question should be, why was this program established in the first place? What was the perceived societal need for a Government response? Then that would lead to an evaluation of whether that need still exists, and if it doesn't, then the program probably does not need to exist.

If the need still exists, but the particular tactic to meet that need has proven to be ineffective, then the challenge is not complete by just terminating the program, but asking the question, "what should we do to respond to that continued need?"

Mr. DELLIBOVI. Well that is exactly the approach we have been taking. And in Housing, for instance, we have developed or asked each of the program units to develop business plans for their existing programs. That process, which was initiated by the Assistant Secretary, Austin Fitts, was designed to do exactly that for the programs that exist.

Starting with the question, what business are you in? Why did the government go into that business and how are you accomplishing it. It is through that business plan review that we are then conducting a work load analysis on each of the programs in Housing to determine the resources that need to be allocated to that business.

Senator GRAHAM. I commend you for that. I just will add this word of caution from my own experience. There's a tendency for these types of plans to move quickly from being a navigator to being a mechanic of transmission. And I think it's very important that you start with some of those broad questions of what it is we're trying to accomplish, was the environment that led to this initially still in place or has it substantially changed, and what does all of that say about what is an appropriate role for government today.

Mr. DELLIBOVI. Your point is well taken——

Senator GRAHAM. I can tell you those are the tough questions. It gets easier from there on.

Mr. DELLIBOVI. You are absolutely right Mr. Chairman, and I would offer as an example the problems we've had when we found that some of our multifamily programs were straying into the luxury housing field. And that's exactly an example of where people thought the business was multifamily and lost sight of who the target of the multifamily housing that the Federal Government initiated should be.

And Jack Kemp believes, as I do, very strongly that the target is not luxury housing. The target is low- and moderate-income housing.

Senator GRAHAM. I would even modify that. The targets are low- and moderate-income families. And the tactic to meet their needs is a second consideration, but it's the people who are your primary goals.

Mr. DelliBovi, we discussed in Mr. Adams' testimony and your remarks programs that have been recommended or are, in fact, now terminated such as the title X program. Mr. Adams made the point that because a program is terminated is not an indication that it is no longer a demand in terms of staffing on the Department.

In fact, sometimes the burial problems are as severe as keeping the patient alive. Are you satisfied the Department has properly addressed the staff requirements to wind down the programs that are being terminated?

Mr. DELLIBOVI. For each of the programs that are terminated or are being reconfigured, we are very much aware of the need to manage what is in the inventory or in the pipeline. For each of the programs, we are taking the steps necessary to handle the assets and the existing commitments in the way that is most cost effective for the federal government.

Senator GRAHAM. Financial management systems and their weaknesses have been identified throughout our course of hearings as a recurring problem at HUD. Your report indicates that you've organized a number of special task forces to look into and to attack the problem of information needs.

What are the most critical systems that the Department thinks it must deal with first, and what is your timetable for doing so?

Mr. DELLIBOVI. Managing cash is the most critical need, and each of those 26 task forces focuses on improving our cash management.

We have taken substantial steps in single family property. We have taken steps in the property disposition area of single family that created the Marilyn Harrel situation, but we are continuing to go through each of the programs and look at the receivables. Is there a better way we can safeguard to make sure everything that we are owed makes its way to the Treasury? That is the question we ask.

And also the payables: are we paying out the right amount. The biggest payable problem that I see is the section 8 program. The certificates and program was not well planned. I don't believe it was really planned at all. We're in a situation now where, as you know, we're not even sure of the exact dollar value of the expiring certificates, so we can't even give valid data to the appropriations committees about our needs.

We are not sure that the public housing authorities are paying out the correct amounts, validating the eligibility of the recipients. This has been going on for 15 years since the program started, and what we have to do is go back to almost the very beginning and recheck the payment systems.

We have an automated system that is now and up and running in 2 of our offices. When the kinks are fully worked out of that, we will be able to apply that in other offices.

But that, too, is an effort that probably will take us another 24 months or more before we are able to input all the data that we need so that it can be automatically processed and checked. We are repeating that kind of operation for each of the vulnerable areas that we identify. The Chief Financial Officer, when established—we're recruiting actively now; someone will be in that job in an acting basis in early July—but will be focusing on exactly those systems and statistics department-wide.

Senator GRAHAM. Mr. DelliBovi, I have two final questions. One, my colleague, Senator Mack, who could not be with us today, at our hearing on April 23, asked about the status of the Chief Financial Officer for the Department.

At the time it was indicated that the Department had reopened the search and hoped to have the Chief Financial Officer selected by June 15. I wonder if you could give us an update as to the status of that position.

Mr. DELLIBOVI. Yes, I'll be pleased to do so. We have been consulting with people in the financial community, chief financial officers of major corporations. Yesterday I met with the director of the Financial Executives Institute, which is the professional organization of chief financial officers.

We have been doing all of this so that we are assured that when the formal advertisement under the Federal personnel procedures is published that we have the widest possible net cast for qualified candidates. And we are going to continue that outreach effort.

The first search provided a very limited number of qualified candidates. Although over 300 people applied for the position, the final list for interviews by the blue ribbon panel that was established, with former Controller Elmer Statz as a leader of that panel, was only able to review twenty or so candidates. From that review they only identified 2 that they could recommend to the Secretary for the Chief Financial Officer.

When the panel reconvenes, we want it to have a broader number of candidates. The panel did good work. The initial search, which was for both the Chief Financial Officer and the FHA Controller, did yield a very highly qualified candidate for the FHA Controller.

The searches, the interviews, are completed or nearing completion for the other controllers. But the right candidate for the CFO position continues to elude us.

For that reason, on July 9, we will be bringing in on an acting basis someone who will occupy that office, set it up, get it up and running with the help of the controllers and some outside assistance as well: the National Academy of Public Administration, who helped us in the original concept, will be involved. I've also asked this Financial Executives Institute if they can provide from their membership some advisory people who would help us as we try to set this up.

I think that as the summer draws to a close, and executive search consultants have told us that July and August is not the best time to be looking for qualified people, we hope to get the full search underway, have the advertisement out in early September, and bring on board a qualified person before the end of the year.

We've been very hampered, I have to be honest with you, and allow me to take a few minutes to give you a flavor of this search. Everyone that I've talked to—the managing directors of all of the large accounting firms in this country, executive search firms—the first question is the salary. And when they hear it's $83,000 a year, there are a lot of private sector firms searching for chief financial officers that pay a lot more.

In January, of course, that salary is expected to jump. And although it still won't be compatible with the private sector, it will be more tolerable. But if you think of what we're looking for, the FHA controller supervises a very large insurance company. The single family program alone is larger than Travellers.

HUD, as we've said repeatedly, the Chief Financial Officer that we bring on board will be equivalent to the chief financial officer of any of the Top Fortune 50 companies. It's really a big job, and qualified people are accustomed to receiving a very large salary.

Now we're looking for somebody who's not just going to be interested in salary obviously. But we want to find the right person, and it's been a difficult process. We're not going to settle for anyone. We want to find the best person, hopefully someone highly motivated, who is willing to make some sacrifices in order to be a public servant in a critical job at a critical time.

Senator **Graham**. Mr. DelliBovi, I appreciate those comments, and they supplement comments that Mr. Adams made in terms in some of his observations about the staffing needs and what will be required in order to achieve the quality of personnel. I would encourage you in your dealings with the Office of Management and Budget and with Congress to be as forthcoming on that issue as possible so that we can take your needs and your assessment of what is required in order to give you the personnel to accomplish an extremely difficult task with proper attention.

Mr. DelliBovi, the last question that I have relates to H.R. 1, the HUD reform act. This act was developed in response to some of the alleged abuses at the Department. H.R. 1, placed stronger controls over HUD to prevent influence peddling and other forms of abuse. Now that that has been effect for several months, do you feel that there are any gaps that this subcommittee should be familiar with, any recommendations that you would present to us that we should make to our legislative colleagues in order to prevent future abuses.

Mr. **DelliBovi**. The one point I would like to make is that many of the provisions of H.R. 1, call for the issuance of regulations, subsidy layering, for instance, which I know is of particular interest to this committee. We cannot as a result of the legislation put the criteria in place that we all want to do until we issue a new regulation.

Regulations are a very cumbersome, time-consuming process. So, it takes over 180 days to develop and issue a regulation. As a result of H.R. 1, we were called upon to issue a large number of regulations. These get crowded in the pipeline.

Hindsight, of course, is always 20–20 in this business. I think if I were redrafting H.R. 1, I would ask for a provision that gives the Secretary the authority to act administratively immediately with new provisions while the regulatory process takes its course.

Whether we need that fix at this time, I'm not sure. We are moving on the regulations, so it might be that that kind of an approach would be too late. I will assure you that after we have launched the implementation phase of all of the reforms, we plan to reconvene internally.

Frank Keating, our General Counsel, will again chair the internal task force that the Secretary and I asked him to chair last year that led our "clearing the decks" proposal and passage of H.R. 1, to go back and to review the various proposals that we did not include in reform 1, either because we couldn't develop the fix in our mind, it couldn't crystallize with the Staff, or because of new problems that have cropped up.

Reform will be an ongoing effort at HUD. We intend to institutionalize it, and I expect that we will be making more recommendations in the future about other improvements that can be made to our programs. But we've not yet begun that effort.

We do have a catalogue, a list of suggestions that we didn't get to in reform 1, and we will be going back to the staff as soon as we get reform 1 fully implemented or along the road. I mean, the problem, Mr. Chairman, for us is that the people now implementing these new rules and regulations, the people working on that in the General Counsel's office, for instance, are the very same people who worked on the legislative proposal in the first instance.

So they worked on the legislative proposal. Now they're working on the regs. We don't want to deflect them from the regs because we can't implement without the regs, but we do intend to bring them back to looking at future legislation as soon as all of those regs are launched.

Senator **Graham**. Mr. DelliBovi, thank you very much. We appreciate your, again, very constructive contribution to the work of this subcommittee.

Mr. **DelliBovi**. Thank you very much, Mr. Chairman.

Senator **Graham**. If the members of panel 3 could please come forward.

Mr. Chaisson, I want to thank you for your assistance to the subcommittee and to the staff throughout these hearings.

Mr. **Chaisson**. Thank you very much, Mr. Graham.

Senator **Graham**. Mr. DelliBovi is very fortunate to have you as his special assistant.

Good morning, gentlemen. In the interest of time, I would request if you could summarize your opening statement, the full statement will appear in the record, and then we'll proceed to some questions.

I will call on the members of the panel as they appear in my agenda. First, Mr. Maloney, Deputy Assistant Attorney General.

STATEMENT OF PAUL MALONEY, SPECIAL ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, DEPARTMENT OF JUSTICE

Mr. **Maloney**. Thank you, Mr. Chairman. I appreciate the opportunity of being here this morning. I am accompanied by Mr. Jack Keeney, also a Deputy Assistant Attorney General in the Criminal Division, Department of Justice.

Mr. Keeney supervises the Public Integrity Section of the Division and has responsibility, among other duties, for the Independent Counsel Act. So he is here to address any questions that the chairman might have in regard to the interface between the Independent Counsel and the Department of Justice.

I have supervisory responsibility over the fraud section, which oversees the division's fraud enforcement efforts. Criminal fraud against HUD has long been an integral part of the Department's enforcement efforts. The Federal Bureau of Investigation on the investigative side and the United States Attorney's Offices and the fraud section on the prosecutive side have always included a HUD fraud component in their Government fraud programs.

In fact HUD fraud has received second priority in the white collar Government fraud program. Only the defense procurement fraud has higher priority. In fiscal year 1989, FBI investigations resulted in 134 convictions, fines, recoveries and restitution in the amount of $7.6 million.

Preliminary figures can demonstrate that for fiscal year 1990, we are likely to surpass 1989. To date, this fiscal year, almost $10 million in fines, recoveries and restitution has been ordered. Attorney General Thornburgh has pledged his full cooperation and assistance in the investigation and prosecution of HUD fraud.

In July 1989, we went out to the field, Mr. Chairman, to all the United States Attorneys Offices, asking them to sit down with their components of HUD to determine exactly what the situation was in terms of the caseload confronting them, and to ask Washington, to wit, the fraud section, for assistance.

We received requests from Oklahoma City and Denver for assistance, and we have detailed fraud section attorneys to work with the United States Attorney's Offices in those two cities. At the present time, the Bureau is investigating approximately 600 HUD fraud matters nationwide. Although in 1989, there HUD investigations in 83 of the 94 United States Attorney's districts, some districts in the country have experienced a disproportionate number of cases.

We believe this is likely due to the economic conditions which existed in those parts of the country. For example, the western District of Oklahoma, that is, Oklahoma City, and the District of Colorado have experienced particularly heavy HUD caseloads, and in fact those are the areas where fraud section attorneys have been assigned.

We believe that the task force effort in Oklahoma City is an example of the excellent working relationship among the agencies and offices involved in HUD enforcement matters. We formed that unit in 1987, and it has been ongoing since then. In each calendar year, the fraud section has added additional attorney resources from Washington to supplement the Oklahoma City task force effort.

To date the task force efforts have produced felony convictions against 25 individuals, criminal fines of $20,000, in restitution orders in the neighborhood of $2.4 million. Prison terms for offenders have ranged from 2 weekends to 5 years. There are about 30 ongoing matters under investigation in Oklahoma City, and there are 5 cases pending trial.

My statement in full, Mr. Chairman, outlines some of the types of fraud that we've been encountering: equity skimming being one, loan origination fraud being another. I won't burden the record at this point with a recitation of those, but needless to say there are several areas that have merited our attention and we have been doing our very best to address them.

One of the ones that has gotten a lot of recent publicity is the closing agent area, a case involving Marilyn Harrel, "Robin-HUD." She received a substantial 40-month prison sentence for her crimes on June 22, 1990, followed by 3 years probation and received a order of restitution in the amount of $600,000.

In sum, Mr. Chairman, we believe that we have many accomplishments to be proud of as a result of the joint efforts of the Department of Justice, the Housing and Urban Development Inspector General's Office, and the FBI. The semiannual report of Inspector Adams presents in more detail many of these accomplishments. We believe that we have an excellent working relationship, and I'll be happy to respond to any questions that you may have.

[The complete statement of Paul L. Maloney follows:]

Department of Justice

STATEMENT

OF

PAUL L. MALONEY
DEPUTY ASSISTANT ATTORNEY GENERAL
CRIMINAL DIVISION

BEFORE THE

HUD/MOD REHAB INVESTIGATION SUBCOMMITTEE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

CONCERNING

CRIMINAL INVESTIGATION AND PROSECUTION OF FRAUD
AGAINST THE
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

ON

JUNE 29, 1990

Good morning, Mr. Chairman and members of the Subcommittee. My name is Paul L. Maloney. I am a Deputy Assistant Attorney General in the Criminal Division. In that position, I have supervisory responsibility for the Fraud Section, which oversees the Division's fraud enforcement efforts. I have been asked to discuss the Department of Justice's efforts in investigating and prosecuting criminal fraud against the Department of Housing and Urban Development. Appearing with me today is Deputy Assistant Attorney General John C. Keeney, who oversees the operations of the Public Integrity Section. The Public Integrity Section has responsibility for, among other things, the Independent Counsel Act.

Criminal fraud against Department of Housing and Urban Development programs has long been an integral part of the Department's enforcement efforts. The Federal Bureau of Investigation, on the investigative side, and the United States Attorneys' Offices and the Fraud Section, on the prosecutive side, have always included a HUD fraud component in their government fraud programs. Within the FBI's Government Fraud Subprogram, (a part of the White-Collar Crime Program), HUD fraud investigations ranked second in terms of dedicated FBI manpower during fiscal years 1987, 1988, and 1989, and still rank second in 1990. Only Department of Defense fraud is the subject of the expenditure of greater resources within that subprogram. In addition, in light of the revelations last year concerning problems associated with a number of HUD programs, the Department sharpened its focus on its HUD fraud enforcement efforts. In fiscal year 1989, FBI investigations resulted in 134 convictions, and fines, recoveries and restitution in the amount of $7.6 million. Preliminary figures demonstrate that fiscal year 1990 will likely surpass 1989 -- to date, this fiscal year, almost $10 million in fines, recoveries and restitution has been ordered. In addition, the FBI reports that it is utilizing more resources on HUD fraud matters this fiscal year.

The Attorney General has pledged his full cooperation and assistance in the investigation and prosecution of fraud and corruption in connection with HUD programs. In July, 1989, all United States Attorneys were instructed to discuss their current and prospective HUD caseloads with the FBI and with the HUD Inspector General in order to devise a plan for addressing all HUD cases as expeditiously as possible. Each district was asked to report to the Criminal Division any anticipated problems in dealing with its HUD cases. United States Attorneys' requests for supplemental resources were granted. In September, 1989, in recognition of the Department's continuing commitment to HUD enforcement matters, the Attorney General created the HUD Fraud and Corruption Coordinating Group within the Criminal Division. That Group's function is to coordinate the efforts of the Department, the FBI, and the Office of the Inspector General so that the goals of effective law enforcement and efficient use of resources are met in the HUD arena.

The FBI is investigating approximately 600 HUD fraud matters nationwide. Although in 1989 there were HUD investigations in 83 of the 94 federal judicial districts, some districts have experienced a disproportionate number of cases. This is likely due, at least in part, to economic conditions which existed in certain parts of the country in the mid-1980's which rendered the real estate market ripe for the commission of fraud offenses. For example, the Western District of Oklahoma (Oklahoma City) and the District of Colorado experienced heavy HUD caseloads. In response to requests for assistance from both of those districts, the Fraud Section assigned attorneys to work HUD matters in Oklahoma City and Denver. Those Fraud Section attorneys work in a task force setting with the FBI, the Office of Inspector General, and the United States Attorney.

The task force effort in Oklahoma City is an example of the excellent working relationship among the agencies and offices involved in HUD fraud enforcement efforts. In September 1987, the Fraud Section of the Criminal Division assigned an attorney to work on HUD and bank fraud related cases in Oklahoma City in association with a cross-designated attorney provided by the Office of the Comptroller of the Currency and agents of the FBI. In late 1988, an additional full-time attorney was assigned from the Fraud Section to participate in the formation of a task force approach for HUD matters. In support of the Task Force, HUD has funded an attorney to work in cooperation with Fraud Section personnel and the United States Attorney's staff. In addition, HUD has also provided office space, clerical staff, and other support services. An additional two Fraud Section attorneys joined the task force in 1989. To date, the task force's efforts have produced felony convictions against 25 individuals, criminal fines of $20,000, and restitution orders in the amount of $2,439,489. Prison terms have ranged from two weekends to 5 years.

The Oklahoma City task force currently has a caseload of approximately 30 matters under investigation and 5 cases pending trial. In terms of the types of cases under investigation, that caseload is similar to that of many other districts across the country. For example, it includes fraud in connection with the origination of HUD insured home mortgages (the FHA home mortgage insurance program), which involves making false statements and other fraudulent acts to deceive HUD, mortgage companies or banks, closing companies, and sellers into believing that the buyer has the necessary cash and credit-worthiness to qualify for a mortgage loan and for HUD insurance on that loan. Loan origination fraud schemes, which frequently involve employees of lending institutions, realtors, and loan closers as co-schemers, usually involve violations of the false statement statutes (18 U.S.C. 1001 and 1010), mail and wire fraud (18 U.S.C. 1341 and 1343), and conspiracy (18 U.S.C. 371).

Equity skimming cases, either in conjunction with or separate from a loan origination scheme, also comprise a large amount of the Oklahoma City caseload. As the term equity skimming implies, investors or brokers seek to realize the value of the real, or in some cases, falsely generated equity value in HUD insured properties. Under one type of equity skimming scheme, an investor utilizes a strawbuyer, false statements, and false credit information to generate a HUD insured mortgage. Subsequent to the real estate closing, the strawbuyer signs the property over to the investor on a quit claim (simple assumption) deed, under which all rights to the property are relinquished and no guaranty of title is made. The investor will then rent the property to a third party and continue to collect rents until foreclosure and eviction, which process can take up to two years. Because equity skimming schemes involve numbers of properties and require obtaining the testimony of many sellers and tenants, investigation and prosecution of these cases is resource intensive. Moreover, since the events which constitute the offense frequently are almost five years old, locating witnesses who can recall the transactions is difficult.

A variation on the scheme involves otherwise genuine and honest homeowners who are in financial difficulty or who desire to relocate elsewhere. The unsuspecting homeowner is approached by one who offers to assume the HUD insured mortgage and promises to make the mortgage payments and save the owner's credit rating. The homeowner is induced to transfer his interest in the property to the alleged "investor", who then rents the home while making no mortgage payments, pending foreclosure. Of course, HUD always loses where the scheme includes HUD insured properties because HUD must pay the lender pursuant to the commitment of HUD insurance on the mortgage. Equity skimming cases are prosecuted under a specific statute (12 U.S.C. 1709-2), but may also involve violations of the mail fraud statute (18 U.S.C. 1341) if mailings were made in furtherance of the scheme.

There have been, of course, prosecutions in various districts covering a range of HUD programs, including rental assistance fraud committed by individual tenants, embezzlement by managers of HUD subsidized projects, and fraud and false statements in connection with the award of HUD program funds.

One category of HUD fraud which received a significant amount of media attention is fraud and embezzlement committed by "closing agents". Under HUD's property disposition program, closings on the sales of properties which HUD acquires in settlement of claims under the Mortgage Insurance Program are handled by closing agents who act under the terms of a contract with HUD. After sales closings, the closing agents are to wire the net proceeds from the property sale to the United States Treasury within one banking day after settlement. As a result of audits conducted by Inspector General Adams, serious irregularities, including alleged criminal conduct, were identified in connection with the activities of a number of closing agents. Those cases, which involve substantial losses to the government, have received the vigorous attention of th FBI, the requisite United States Attorneys, and the Inspector General.

One such case, United States v. Marilyn Harrell, involved a former HUD contract closing agent in Clinton, Maryland, who embezzled over $5 million from escrow accounts between 1985 and 1988. Because Ms. Harrell claimed that she embezzled the funds to benefit the poor, the media nicknamed her "Robin HUD". Harrell pled guilty to theft of government property and filing a false tax return. On June 22, 1990, Harrell was sentenced to 46 months incarceration, to be followed by three years probation, and ordered to make restitution in the amount of $600,000, and perform four hours of community service per week during her term of probation.

Another HUD closing agent, Reba Lovell, of Arlington, Texas, was sentenced to 6 1/2 years imprisonment, five years probation, and ordered to perform 500 hours of community service following her plea of guilty to three counts of theft of government property and one count of money laundering. Lovell had embezzled $2.5 million in escrow funds.

In United States v. Silas Walker, a Montgomery, Alabama HUD contract closing agent pled guilty to one count of embezzlement and one count of tax evasion in connection with the theft of over $2 million. On May 1, 1990, he was sentenced to a term of six years incarceration, and ordered to pay a fine of $2 million and make restitution in the amount of $2.7 million.

In Denver, Colorado, an accountant formerly employed at HUD's Denver regional office, was charged with embezzling over $1 million in HUD funds which had been appropriated to subsidize low-income housing. The defendant, Douglas Turner, entered a guilty plea to one count of theft of government property and was sentenced to a term of 27 months imprisonment, three years probation, and ordered to make restitution to HUD in the amount of over $1 million.

Another matter which has received significant media attention is corruption among officials of Public Housing Authorities. This problem has received the attention of the Department of Justice. For example, as a result of investigative efforts, the former Executive Directors of the Carteret, Perth Amboy, and Woodbridge, New Jersey Housing Authorities all pled guilty to accepting bribes in connection with the award of Housing Authority contracts. The three executive directors have been sentenced to terms of imprisonment ranging from 21 months to four years, and fines of $40,000. Officials of other housing authorities (in New Orleans, and Charleston, West Virginia), have also been subject to criminal prosecution for bribery/kickback schemes.

These are but a few of the accomplishments of the joint efforts of the Department of Justice, the FBI, and the Office of Inspector General in the HUD fraud enforcement arena. The semiannual report of Inspector General Adams, which was presented today, delineates many more of those accomplishments.

This concludes my prepared remarks. I will be pleased to entertain questions from the Subcommittee members.

Senator **Graham**. Thank you very much, Mr. Maloney. Mr. John Keeney, Deputy Assistant Attorney General.

STATEMENT OF JOHN KEENEY, DEPUTY ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, DEPARTMENT OF JUSTICE

Mr. **Keeney**. Mr. Chairman, as Mr. Maloney indicated, my comments will be directed to the division of responsibility on HUD matters between the Department of Justice and Independent Counsel, Judge Adams.

Now the appointment of an Independent Counsel in this matter resulted from several events. One, the primary one, the first one, was the lengthy audit investigative report on the administration of HUD's Mod Rehab Program under Secretary Pierce. That was prepared by Mr. Adams.

The second primary event in this regard was the hearings of the House Committee on Employment and Housing of Government Operations chaired by Chairman Tom Lantos. At those hearings, Chairman Pierce initially appeared and answered questions. He subsequently declined to make any further appearances.

While the hearings were going on, the majority of the House Judiciary Committee under the Independent Counsel Act provisions, petitioned the Attorney General for the appointment of an independent counsel. After conducting a preliminary investigation for the statutory 90-day period, the Attorney General petitioned the special court to appoint an independent counsel to determine whether Secretary Pierce and other officials of HUD may have committed the crime of conspiracy to defraud the United States and any other crimes relating to the administration of the selection process of the Mod Rehab Program from 1984 through 1988 inclusive. Subsequently Judge Arlin Adams was appointed to carry out that function.

Later, at the end of April and early May, DuBois Gilliam, former Deputy Assistant Secretary for Program Policy Development Evaluation at HUD testified before the Lantos committee under a grant of immunity. He testified concerning the administration of the selection process of HUD's Urban Development Action Grant program and the programs within the Secretary's discretionary fund, technical assistance program, and special projects.

Mr. Gilliam's allegations concerning the funding decisions of these programs were related to the allegations that the independent counsel was already investigating concerning MRP. Accordingly, the Attorney General on May 25 referred these allegations to the independent counsel pursuant to the independent counsel statute. We anticipate that the independent counsel will accept the referral.

I might point out in closing that we have met on several occasions with the independent counsel and his staff and we have a very excellent relationship. We anticipate that relationship will continue and that we will be able to divide responsibilities in the HUD investigations without great difficulty.

That concludes my remarks, Mr. Chairman.

[The complete statement of John C. Keeney follows:]

Department of Justice

STATEMENT

OF

JOHN C. KEENEY
DEPUTY ASSISTANT ATTORNEY GENERAL
CRIMINAL DIVISION

BEFORE THE

HUD/MOD REHAB INVESTIGATION SUBCOMMITTEE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

CONCERNING

CRIMINAL INVESTIGATION AND PROSECUTION OF FRAUD
AGAINST THE
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

ON

JUNE 29, 1990

Good morning Mr. Chairman and members of the Subcommittee. I am John C. Keeney, Deputy Assistant Attorney General, Criminal Division, United States Department of Justice. Among other duties, I oversee the Department's compliance with the Independent Counsel provisions of the Ethics in Government Act (the "Act"), 28 U.S.C. §§ 591 et seq. My statement addresses the division of responsibilities on HUD matters between the Department of Justice and Independent Counsel Arlin M. Adams.

As you know, in April of 1989, HUD's Inspector General (the "IG") released a lengthy audit and investigative report on the administration of HUD's Moderate Rehabilitation Program (the "MRP") under Secretary Samuel R. Pierce, Jr., during the years 1984 through 1988. Shortly thereafter, the House Subcommittee on Employment and Housing of the Government Operations Committee, chaired by Congressman Tom Lantos (the "Lantos Subcommittee"), began hearings that focused on the manner in which MRP funding was awarded. On May 25, 1989, Secretary Pierce testified before the Lantos Subcommittee about his role on the MRP funding decisions.

The Department of Justice closely monitored the Lantos Subcommittee hearings. On November 3, 1989, with the Subcommittee's investigation of the MRP largely concluded, a majority of the Democratic members of the House Judiciary Committee sent a letter to the Attorney General. The letter, which constituted a Congressional Request under Section 592(g) of the Act, asked the Attorney General to apply to the Special Division of the Court for the appointment of an Independent Counsel to investigate whether Secretary Pierce had violated federal criminal laws prohibiting conspiracy to defraud the United States, and had committed perjury in his testimony before the Lantos Subcommittee.

After the massive amounts of information generated by the investigations of the IG and the Lantos Subcommittee was digested, the Attorney General directed the commencement of a preliminary investigation. On February 1, 1990, with the preliminary investigation completed, the Attorney General filed an application with the Special Division of the Court, seeking the appointment of an Independent Counsel on this matter. The application noted that the Attorney General was constrained by the state of the record and by his limited powers under the Act to seek an Independent Counsel to determine whether Secretary Pierce and other officials of HUD may have committed the crime of conspiracy to defraud the United States or any other crimes relating to the administration of the selection process of the MRP from 1984 through 1988, inclusive. Because the allegations that Secretary Pierce committed perjury in his testimony before the Lantos Subcommittee were not, in the Attorney General's view, well-founded, he declined to request that the perjury allegations be included in the Independent Counsel's jurisdiction.

On March 1, 1990, the Special Division of the Court appointed Judge Adams as the Independent Counsel, and defined his jurisdiction in accordance with the Attorney General's application. The Department of Justice immediately made available to the Independent Counsel and his staff all documents in its possession concerning this matter. The Independent Counsel and his staff have met with the Assistant Attorney General, and we have developed a good working relationship. We are coordinating with the Independent Counsel the investigation of various HUD matters across the country, and do not anticipate any difficulties in apportioning the cases in accordance with the Independent Counsel's mandate.

On April 30, May 2, and May 4, 1990, DuBois Gilliam, former Deputy Assistant Secretary for Program Policy Development and Evaluation at HUD testified under a grant of immunity before the Lantos Subcommittee. Mr. Gilliam is currently serving an 18-month sentence in connection with his guilty pleas to two counts of accepting gratuities in a case prosecuted by the Public Integrity Section in the District of Columbia, and one count of conspiracy to defraud the United States in the Southern District of Mississippi. Mr. Gilliam testified concerning the administration of the selection process of HUD's Urban Development Action Grant program and the programs within the Secretary's Discretionary Fund (Technical Assistance Program and Special Projects). Mr. Gilliam's allegations concerning the funding decisions in these programs were related to the allegations the Independent Counsel was already investigating concerning the MRP. Accordingly, on May 25, 1990, the Attorney General referred those allegations to the Independent Counsel pursuant to Section 594(e) of the Act. We anticipate that the Independent Counsel will accept the referral.

Senator **Graham**. Mr. Keeney, before we go on, in the report which Mr. Adams summarized on panel 1, there were some other areas that may have had circumstances similar to moderate rehabilitation, the title X program being one. Is it your intention to suggest that those areas also be added to the jurisdiction of the Counsel?

Mr. **Keeney**. Mr. Chairman, what we'll do is we'll review and analyze those and determine whether or not they properly belong within Judge Adams' jurisdiction. And where there are situations where there is a close relationship, we will sit down and discuss them with Judge Adams.

Our understanding with Judge Adams is that he can have access to anything the Criminal Division of the Department of Justice and the United States Attorneys have with respect to investigations of HUD. The files are open to him. If he feels that any one of these matters is close to his jurisdiction or that it would be useful, helpful and efficient that he have these matters, the understanding is that we will have a discussion with respect to them and that we will take a very liberal attitude with respect to his jurisdiction.

So the short answer is, yes, we will look at them and see whether or not they belong more properly with Judge Adams or with the Department.

Senator **Graham**. Mr. Frank Keating, General Counsel of the Department of Housing and Urban Development.

STATEMENT OF FRANK KEATING, GENERAL COUNSEL, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. **Keating**. Mr. Chairman, as you've noted, I would appreciate if my formal statement could be made a part of the record, and I do have several complimentary things to say as a postscript to that statement that might be of some interest to the chairman and to the subcommittee.

Secretary Kemp when he first came aboard, when he first learned of the fact that there appeared to be problems with the manner in which the Department was managed in the past, met with Inspector General Adams. I attended those meetings, and we examined the audit reports which became the basis for the Lantos hearings and certainly that were used by this subcommittee in its examination of the various problems that have afflicted HUD.

What is important about that meeting is that as the result of those meetings, all of those audit reports which would suggest the possibility of criminal misconduct, even the faintest evidence of criminal misconduct were referred to the Public Integrity Section of the Department of Justice. Subsequent to that, the Secretary ordered all of the inspectors general under Mr. Adams' jurisdiction to meet with the U.S. Attorneys in their jurisdictions and to share with them any information that they might have relative to misconduct by HUD employees or in HUD programs.

After that we did a number of things at the Department that are not noted in my testimony that I think the chairman would be happy to hear. First, we created an asset recovery strike force under Mr. John Kennedy's direction, to my left, who is Associate General Counsel for Program Enforcement, for the purpose of going after civilly those institutions or individuals who misbehaved in the manner in which they conducted themselves in HUD programs. The asset recovery strike force to date has filed some eighteen cases and already recovered nearly $6 million from closing agents and from others who had abused HUD programs.

Additionally we created a distressed property strike force after the Congress gave us civil penalty authority last December for the purpose of examining the manner in which private owners were using or, in some cases, abusing HUD programs. That distressed property strike force is active and underway.

We have a number of suspension actions, other administrative sanction actions against people, and we intend and are using the civil monetary penalty authority for the purpose of penalizing those who attempt only to suck out of these developments the maximum return they can and don't, in many cases, put enough back to provide for the basic conditions that the properties require.

Recently, we also created a strike force which focuses on public housing. And I wanted to share with the chairman the recent Passaic, New Jersey, experience with that strike force, which is related in my testimony because it is very significant. The fact is, on January 18 of this year, our Inspector General, Mr. Adams, issued an audit citing irregularities in that one particular housing authority. This is shortly after we created this strike force.

Some of those allegations included excessive salaries taken by members of the top management. That was on January 18. On Monday, January 22, that is from Friday to Monday, we issued letters of suspension to the executive director, the deputy executive director, the chairman of the board of commissioners, the vice chairman of the board of commissioners, and counsel to the authority.

On the same day, we administratively sanctioned in the Newark office the maintenance supervisor, a consultant and a fee accountant. On that same day also, Mr. Chairman, a letter was hand delivered to the five remaining commissioners of the authority informing them of the administrative actions and advising them of the effects of those actions and asking them to take special action themselves.

On Wednesday, January 24, again less than a week from the time we first discovered there was a problem, the commissioners met with us. At this meeting it became apparent to us that the remaining commissioners would accept no responsibility for misappropriation of funds and irregular practices that we identified, nor did they demonstrate the intention or capability to take necessary action to ensure that the authority was operated in accordance with the law.

After reviewing the facts, on Monday, January 29, just slightly over a week after we discovered these facts, we issued a letter declaring the commissioners in substantial breach of their agreements with us and notifying them that we would take, that is, the Department would take control of the authority and its assets. This letter was hand delivered to the commissioners. They failed to voluntarily surrender possession of the authority.

At 4:00 p.m. that day, we asked the U.S. District Court for the District of New Jersey to issue a temporary restraining order, which was done. An interim director was placed in charge of that authority, and on January 31, all bank accounts of the authority were turned over to us, and the authority is presently being managed by an individual selected by us.

Obviously it is not the intention of Secretary Kemp to manage housing authorities, but the point I wish to raise here was this is an example of, again, enforcement actions taken by the Department when we identified there was misconduct allegedly occurring, that the taxpayers' monies were in jeopardy, we took action. All of this was done within the space of approximately 1 week.

So a combination of the Secretary's actions up front, the HUD reform bill, as has been noted previously during the course of the three panels, and also our asset recovery strike force, our multifamily or distressed property strike force, and this public housing strike force, I think that we are in a better position to assure, Mr. Chairman, that the taxpayers' monies, in fact, will not be improperly handled.

It has been a very adventuresome year and a half, but I think that it's been done according to proper procedure and I think it's been done in the interests of the taxpayers.

[The complete statement of Frank A. Keating follows:]

INTRODUCTORY REMARKS
FOR TESTIMONY OF FRANK A. KEATING
BEFORE THE SENATE
HUD/MOD REHAB INVESTIGATION SUBCOMMITTEE

INTRODUCTION

Mr. Chairman and members of the subcommittee, I welcome this opportunity to appear before you to discuss the legal results of Secretary Kemp's initiated investigations and the Inspector General's audits within the Department of Housing and Urban Development, as well as the coordination between my office, the HUD Inspector General and the Department of Justice.

In order to better understand the aggressive enforcement approach taken by HUD under Secretary Kemp's stewardship, I would like to take a few moments to describe the various enforcement actions available to the Federal Government, indicate who is responsible for initiating each action and, by way of specific examples, show hcw the aggressive use of these various tools has served the best interests of the Department, the American taxpayer and the Congress.

Since the Under Secretary has already discussed Secretarh Kemp's actions to strengthen and improve financial and management controls over HUD programs that were abused in the past, I will limit my remarks to specific enforcement actions taken by my office.

In your letter to me of June 19, you requested that I discuss the number of cases referred to the Department of Justice for prosecution, as well s the coordination process between my office, the Inspector General and Department of Justice, and my opinion of the priority given to HUD cases by Department of Justice.

In order to better understand the aggressive enforcement approach taken by HUD under this administration, I would like to take a few moments to describe the various enforcement actions available to the Federal Government, indicate who is responsible for initiating each action and, by way of specific examples, show how the aggressive use of these various tools has served the Department, the taxpayer and Congress as well.

Since the Under Secretary has already discussed Secretary Kemp's actions to strengthen and improve financial and management controls over HUD programs that were abused in the past, I will limit my remarks to specific enforcement actions taken by my office.

When specific problems have been identified, HUD has taken aggressive action to resolve the problem. Administrative sanctions have been taken by HUD, both at Headquarters and by field offices. In cases where funds have been misspent, embezzled or diverted to improper uses, we have followed up with demands for a return of the funds, and where necessary, referrals to the Department of Justice for the initiation of a civil recovery action. If the problem identified related to the violation of a criminal statute, the matter would be referred to the IG who, as you know, is responsible for investigations and referral of such matters to the Department of Justice for prosecution.

As you will see from the two examples which are describle latter in my statement a particular problem could involve all three types of enforcement actions -- administrative, civil recovery and criminal.

A short description of the various administrative sanctions which HUD can impose would be useful at this point. Let me say at the outset that administrative sanctions bar someone from participating in HUD programs in the future.

The least severe sanction which HUD can impose is a Limited Denial of Participation (LDP). An LDP may be imposed by a HUD field office, and it excludes a person from participating in specified programs within the jurisdiction of the field office for a period of one year. This sanction is prospective and has no automatic impact on existing contracts or agreements, although existing contracts may be terminated at the direction of HUD and in accordance with applicable law.

Suspension is a temporary action which immediately excludes a person from participating in Federal programs, nationwide. A suspension taken pending the completion of an investigation may not last longer than one year, except that it can be extended for six months at the request of an Assistant Attorney General or U. S. Attorney. HUD sanctions apply to both "contractors" and "participants". Therefore, a suspended participant may not enter into procurement contracts with HUD. Nor may an excluded contractor participate otherwise in HUD programs, for example, as the owner of a property which has a HUD insured mortgage or as the recipient of a grant.

When a person is suspended, there is no automatic effect on existing contracts or agreements, but an agency may review those agreements to determine whether termination is in the best interests of the government. Contracts or agreements may not be renewed, nor may new ones be entered into with a suspended person, unless a compelling need is found.

Finally, HUD has the authority to debar a person from participation in Federal programs for a period of years, or indefinitely in the case of willful or egregious offenses. The effects of debarment are the same as for suspension, except that it is not a temporary or "stop gap" measure designed to protect the government's interests during the course of an investigation.

Let me add that one new sanction has been added to HUD's arsenal, and it holds the potential for significant impact on participants of HUD's programs. Thanks to the enactment of the HUD Reform Act and the efforts of Congress, the Secretary now has the authority to impose civil money penalties on a number of the participants of HUD's programs who engage in certain prohibited activities.

While the aggressive imposition of administrative sanctions will protect HUD in the future, they do not generally result in a return of HUD funds improperly taken.

So let me now turn to the "civil recovery" aspect of HUD's enforcement actions. Most typically HUD would initiate this process with a formal demand for a return of HUD's funds from the party who had inappropriately taken them. In the absence of a reasonable response from such party, we would prepare a civil recovery action and, depending on the amount of money to be recovered, forward the case to the Department of Justice or the appropriate United States Attorney's Office.

If a false claim were involved, we would request that the action be brought under the False Claims Act and seek treble damages and forfeitures.

Since January 1989 we have forwarded 39 enforcement cases to the Department of Justice for the initiation of a civil action. We are also tracking 110 restitution orders which were entered in criminal cases and, if complied with, will obviate the necessity for civil recovery cases.

Since the IG has already provided information regarding the number of criminal cases referred to the Department of Justice for prosecution, there is no need to discuss these numbers. However, I will make some references to specific prosecutions in the examples which follow which should illustrate the aggressive approach this administration has taken to the problems which have surfaced in the last year.

Let me first cite HUD's takeover of the Passaic Housing Authority as illustrative of the action HUD will take once a problem is identified.

On January 18, 1990, HUD's Inspector General issued an audit report which cited serious irregularities at the Housing Authority. Excessive salaries were taken by a number of the top managers. It was also apparent that the excessive salaries had been hidden from HUD.

On Monday, January 22, 1990, HUD issued letters of suspension to the Executive Director, the Deputy Executive Director, the Chairman of the Board of Commissioners, the Vice-Chairman of the Board of Commissioners, and the Counsel to the Authority.

On the same day, letters of limited denial of participation had been issued by the Newark Area Office to the Chief of Operations, a Maintenance Supervisor, a Consultant, and a Fee Accountant.

That same day a letter was hand-delivered to the five remaining Commissioners of the Passaic Housing Authority (Authority), which informed them of HUD's administrative actions and advised them of the effect of these actions. The most significant effect was that the persons who were LDP'd could not participate in the HUD programs from which they had been denied participation, and the suspended individuals could not participate in HUD programs nor receive federal funds.

The Commissioners charged with the oversight of the operations of the Housing Authority had indicated in their response to the draft audit that they were contemplating no corrective action. In our letter to the Commissioners who had not been suspended, HUD asked that a meeting be convened to determine how they intended to recover the misappropriated funds.

HUD asked that the Commissioners meet with representatives from HUD on Wednesday, January 24, 1990, to discuss their actions and intentions.

On Wednesday, January 24, 1990, the Commissioners met with HUD. At this meeting it became apparent that the remaining Commissioners accepted no responsibility for misappropriation of funds and the irregular practices nor did they demonstrate the intention or capability to take the necessary corrective action and ensure that the Authority be operated in accordance with the federal laws and contracts.

After reviewing the facts of the case on Monday, January 29, 1990, HUD issued a letter declaring the Commissioners in substantial breach of the annual contributions contract and informed them that HUD would take possession of the Authority and its assets. This letter was hand delivered to the Commissioners. They failed to voluntarily surrender possession of the Authority and at 4:00 p.m. HUD asked the United States District Court for the District of New Jersey to issue a temporary restraining order requiring the Commissioner's to surrender possession of the Authority, its assets, and operations to HUD. After a contested hearing the United States District Court issued an oral order granting HUD its injunctive relief. On Tuesday, January 30, 1990, a HUD employee became the interim executive director of the Passaic Housing Authority. On Wednesday, January 31, 1990, all bank accounts of the Authority were turned over to HUD and the Authority is presently being managed by an individual selected by HUD.

In Passaic, all three types of enforcement actions were effectively used to accomplish HUD's objectives. Administrative sanctions were imposed immediately. Criminal cases were developed and thur far the Deputy Executive Director, the Chief of Operations and the Maintenance Chief have plead guilty to criminal charges. At the same time, my office has been in almost daily contact with the Chief of the Civil Division in Newark to pursue settlements of the civil liability of the same parties which, if not agreed to by those parties, will be followed by the initiation of civil recovery actions in the United States District Court.

The same enforcement approach was followed by HUD after the closing agent problem surfaced when Marilyn Harrell, the infamous "Robin HUD", embezzeled over 5-1/2 million dollars. I created a Strike Force within my office which applied the same enforcement tools to the 18 escrow agent cases which they tracked. In every case, administrative sanctions, civil recovery and criminal prosecution were considered. Twenty-four administrative sanctions have been taken by HUD, $5,608,000 has been recovered to date through demand letters, settlements and civil recovery cases, and eight individuals have been indicted, 6 have plead guilty to embezzlement or other related charges and 4 cases remain under investigation.

Let me conclude with a few general remarks as to the coordination between my office, the IG and the Department of Justice. The examples cited earlier of Passaic and embezzlements by escrow agents are indicative of the excellent coordination between my office, the IG and the Department of Justice. The dedication of all these individuals has permitted HUD to take quick and effective actions to address the enormous problems facing HUD. The priority given to HUD cases by the Department of Justice, both criminal and civil, has been a major factor in HUD's ability to act quickly and decisively.

Thank you.

Senator **Graham**. Thank you very much, Mr. Keating. I'm interested in your characterization of this as being an adventuresome period.

Mr. Adams, did you have any further statement to make?

Mr. **Adams**. No, sir.

Senator **Graham**. Mr. Maloney, I'd like to discuss further some of the Department's efforts. Within the Department, what priority is being given to these HUD cases, and has that priority changed in the last 5 years?

Mr. **Maloney**. Mr. Chairman, the Federal Bureau of Investigation has, as indicated earlier, given second priority in the Government fraud subprogram to HUD. Fraud number one in that particular subprogram is defense procurement.

I should say, however, that in terms of looking at it on a somewhat historical basis, the number of work years of agents allocated and also fraud section attorneys allocated has increased over the years in both the investigative and prosecutorial sides. So obviously there are other areas of fraud that are impacted in the fraud section such as the current S&L situation, which also needs attention.

But I think over the years the efforts have been strong, and we certainly pledge to continue those efforts, and as far as the fraud section of the division is concerned, where there is a need out in the field, such as I indicated near Oklahoma City and in Denver as a result of the review that occurred at midyear last year, the direction of the Attorney General, if it is at possible, we will attempt to fill those needs in the field.

Senator **Graham**. Well I'm concerned about what the Budget Office indicates has been the recent pattern. Since 1982 the HUD IG has referred on average 200 cases a year to U.S. Attorneys. The Department of Justice resources devoted to HUD criminal cases from 1985 to 1988 went from two full-time attorneys to one, and by fiscal year 1988, there were no attorneys assigned full-time to these HUD cases.

That pattern would not indicate that there has been much of a priority prior to 1988. Is that an accurate statement of the Department of Justice's position and, if so, why were these cases given low priority?

Mr. **Maloney**. Well, Mr. Chairman, of course, I take it from your remarks that we're centering on the fraud section, criminal division, effort in this area. We assigned a full time attorney to—let's take Oklahoma City, for example, to give you some idea of what's been happening.

We assigned a full-time attorney in Oklahoma City in late 1987, recognizing the need in that particular locale. We supplemented that in 1988 with an additional fraud section attorney, and then in 1989, as a result of the review, in general fashion in HUD, we've got two attorneys now working out of Denver.

So we estimate based on the figures that have been given to me, that we have the equivalent of 6 attorneys in the fraud section working on HUD-related matters, which is a substantial increase from earlier.

Senator **Graham**. Are these numbers that were developed by the Budget Office from 1985 to 1988, do they coincide with your assessment of the resources that were available to handle these HUD fraud cases?

Mr. **Maloney**. I don't believe so, Mr. Chairman. What I can do is I can, if the Staff will forward me the numbers, I can check them and we'll get back to you.

We should also—my colleagues make a fine point, Mr. Chairman. When we center on the fraud section, we tend to lose the fact that the Assistant United States Attorneys are being assigned in the 94 districts in this area as well. So it doesn't give you a full picture if we just center on the fraud section, although I must say that the fraud section's efforts have been increasing, and again I'll be happy to check the Budget Office figures that you have, with our numbers, and get back to you in writing on that.

Senator **Graham**. One of the questions that has come up in the Savings and Loan, similar circumstance, has been whether the individual U.S. Attorneys' offices have the capacity to effectively investigate and prosecute these cases. And that concern is a function of the complexity of the cases, the uneven distribution of the cases among district attorneys' offices, the other demands placed upon the U.S. Attorneys for normal criminal and other activities.

The Senate is about to adopt a provision that has the goal of enhancing the supervisory and capacity control of the Department of Justice for S&L criminal and fraud cases. Do you feel that any such structural, systemic or personnel enhancement is called for, would be appropriate, would lead to more vigorous pursuit of these HUD cases?

Mr. **Maloney**. Well, Mr. Chairman, let me first say that you're absolutely correct when you indicate that these investigations are resource-intensive. They do take a—they don't get done in a matter of 48 hours. They do take a commitment of agent time on the investigative side and also assisting U.S. Attorneys on the prosecutive side for significant periods of time.

I should say in terms of need for help in the field, the purpose of the 1989 survey was to attempt to find out where the U.S. Attorneys' offices across the country needed assistance of Washington in these areas. As I've indicated, we only got two requests, Denver and Oklahoma City. Implicitly I think that indicates that the U.S. Attorneys were comfortable in dealing with the HUD fraud cases in their districts.

Senator **Graham**. And were you also comfortable in terms of your evaluation of how effectively the cases, the 200 per year that were being referred, were being investigated and prosecuted?

Mr. **Maloney**. I think the areas that we got requests were the two priority areas, Oklahoma City and Denver. There are several other cities across the country that do have heavy caseloads: St. Louis, Chicago, Philadelphia are among them.

The judgment of the U.S. Attorney was that he was comfortable with his resources. Really that's a judgment call that he has to make in relationship with all the other items that are on his plate in terms of violent crime, drugs, and S&L's in those cities where that's a major factor.

Senator **Graham**. As a member of Congress, I can't hold all 95 U.S. Attorneys accountable. I do want to hold somebody at the Department of Justice accountable to answer the question, are you comfortable, prepared to certify to the American people that these cases are being effectively investigated and prosecuted through the current system, and therefore are accepting accountability and responsibility for their faithful discharge?

Mr. **MALONEY**. Senator, you give me a lot of burden to place on the shoulders in answering that question. What I can tell you is is that we believe that given the resources that we have that we are dealing with these in a timely fashion.

Are we saying that in the best of all possible circumstances that we cannot use more resources to attack these cases? I think the Attorney General has indicated that he could always use more resources. But the question boils down to, you know, given the finite amount of resources that we have, are we doing the best job that we feel we could be doing, and I think the answer to that question is yes.

Senator **GRAHAM**. Let me attempt to quantify my question. On a scale of 0 to 10, with 0 being, you know, abject failure and 10 being perfection, Sherlock Holmes accompanied by Perry Mason investigating and prosecuting each case, where would you say your current level of resources puts you on that scale?

Mr. **MALONEY**. Well that's extremely difficult to quantify, Senator. I would certainly say that we are more than past the halfway point on that issue, and certainly closer to 10 than to 0, which, as I understand, on your scale represents abject failure.

Senator **GRAHAM**. So you would say you were 7.438? [Laughter.]

Mr. **MALONEY**. No, I would say we're higher than that, but clearly we have a large job to do and we're going about doing it in the best way we can.

Senator **GRAHAM**. As a general statement to this panel and to Mr. Adams for his earlier presentation, if anyone would like to supplement the record with any further information, you're encouraged and invited to do so.

I would like to ask Mr. Maloney if you could give us, in the form of further data, what would be required to get from where we are now to a ten in terms of a level of prosecution?

Mr. **MALONEY**. I'll do my best to supply that for you, sir.

Senator **GRAHAM**. And to add to that, where there has been a referral for a criminal investigation and it is determined that no criminal prosecution is warranted but that civil claims may be appropriate, what procedure does the Department use to follow up on those civil claims?

Mr. **MALONEY**. The Attorney General encourages the U.S. Attorneys' offices to make referrals to the civil side if that is deemed appropriate. Sometimes, Senator, these cases run on 2 tracks: there is a civil component to the case and a criminal component to the case.

Also in addition there could be an administrative component. If we have declined a case based on my, perhaps, lack of evidence to be able to prove the case beyond a reasonable doubt but we feel that civil remedies are appropriate, the U.S. Attorneys' offices are encouraged to make those referrals, and I think from the comments made by some of the other witnesses that those referrals do in fact occur, and as a result recoveries are received.

Senator **Graham**. Do you feel that you have an adequate legal base to reach out both for criminal and civil recovery to non-governmental persons who may have been involved in a conspiracy to defraud such as professionals as well as developers and others who ultimately benefited by these activities?

Mr. **Maloney**. As a general rule, Mr. Chairman, we're comfortable with the statutory base that we have to deal with these cases. There are specific statutes such as the equity skimming statute that apply in some situations. The false statements statutes and others provide, we think, the statutory base necessary to capture the universe, if you will, of criminal activity that's out there.

So in terms of definitional new crimes, at this point, based on our experience, we don't see a major need for additional legislative fixes in that area.

Senator **Graham**. Mr. Keeney, we understand that last April the Inspector General transmitted his report to you on the investigation that he'd been conducting of the Mod Rehab Program. There was a request that it be reviewed for a determination of criminal prosecution.

We are informed that the Department of Justice limited its review to the evidence in that report concerning Tom Demery only, as requested by the IG's transmittal letter, and as a result, we declined to prosecute. In looking at the copy of the IG's letter, we did not find a request for such a limited review.

Why did the Department restrict its review to Demery when the IG's transmittal letter gave you a broader latitude and when their investigation concerned the administration of the entire program?

Mr. **Keeney**. We didn't limit it to Mr. Demery, Mr. Chairman. We were following with Mr. Adams' staff these various investigations even before the report was issued, and that was why we were in a fairly good position to evaluate the independent counsel aspects of it when they arose.

Demery was the one that seemed most likely to be a violation of law. We looked at that carefully; we evaluated it in terms of people who were recipients of HUD grants who were making contributions to an international organization which Mr. Demery previously had an interest, had some association with.

We didn't find a nexus, a criminal nexus between the contributions that the individuals were making to this organization and any actions taken by Mr. Demery, so we concluded no prosecution.

Senator **Graham**. So you're saying that your review of the Inspector General's report was not limited to just that one individual——

Mr. **Keeney**. That's right. It was not limited. We had an individual who was following—who went entirely through the report and worked with Mr. Adams' staff during the development of the report and, yes, sir, we did not confine our review.

Although the formal, written, declination memorandum was probably confined to the Demery situation. All the other matters were reviewed.

Senator **Graham**. And it was your conclusion that there was not the basis of criminal action against the other persons in addition to Demery who were reviewed?

Mr. **Keeney**. Yes, sir. Yes, sir.

Senator **Graham**. Did you find that, if there had been no criminal violations, that there were any violations of conflict of interest, ethics laws, or other provisions that would have warranted a referral to another entity within the Department of Justice?

Mr. **Keeney**. I don't know what we would have referred within the Department of Justice. If it were an ethical violation that came within the ethics statutes, we would have prosecutive jurisdiction. If it were an administrative matter where action was taken by Mr. Demery or others that were violative of the HUD regs, that would be a matter for action by Mr. Adams and by HUD.

We looked at everything that was criminal, Mr. Chairman, to summarize my answer, and we concluded the one focus which seemed facially might be a violation, we looked at it very hard, and it was reviewed by our attorney, it was reviewed in the normal process, including myself, in the criminal Division. With respect to ethical violations, they would have been handled by HUD.

Senator **Graham**. In your——

Mr. **Keeney**. If there were any. Offhand, I don't recall any.

Senator **Graham**. In your earlier statement you gave sort of a chapter by chapter evolution of this, and one of the early chapters was Congressman Lantos' hearings on this matter. I think your judgments not to prosecute Mr. Demery were made on information available prior to the Lantos hearings.

Was there anything that was developed at those hearings that was not available to you at the time that you reviewed the Inspector General's report, information that might have changed your judgment as to whether there was a basis of a criminal charge against Mr. Demery or other persons who you reviewed?

Mr. **Keeney**. Specifically I can't answer that, whether there was any additional information. What I can say is that the Lantos testimony was reviewed with respect to Demery as well as the other individuals.

Senator **Graham**. And in that——

Mr. **Keeney**. Without changing our conclusions.

Senator **Graham**. Without changing the conclusions. You discussed earlier, Mr. Keeney, the question of the jurisdiction of the independent counsel. Could you summarize where that stands at the present time?

Mr. **Keeney**. Well the independent counsel was appointed, I think, on May 25. It's in my statement, on the date—he's been assembling a staff. Now he has at least 6 people—those I've met, at least—of his staff.

He's working with our people and he's looking at various ancillary matters that he doesn't have directly and we've had some discussions as to whether we should ask the court to extend his jurisdiction to other matters. He's on board; he's in operation, and he's working very closely with us. That's all I really can say about him, Mr. Chairman.

Senator **Graham**. You say you are still in a decisionmaking mode in terms of whether to ask the court for an expansion of jurisdiction.

Mr. **Keeney**. Well we have had discussions with the independent counsel as to whether certain items would come within his jurisdiction, and we've assured him that if the requisite showing were made that these were matters within his jurisdiction, in other words, matters that would relate in some fashion to the activities of the covered person, Mr. Pierce, that we would try to work out a satisfactory relationship with respect to jurisdiction.

Senator Graham. You referred to the testimony by Mr. Gilliam before the Lantos committee. That seemed to raise issues of perjury based on previous testimony of other individuals involved. Does the special counsel currently, the independent counsel have jurisdiction to review perjury issues?

Mr. **Keeney.** Well he's interested in Gilliam. He's told us that—Mr. Chairman, I'm getting a little bit uncomfortable, because we're getting into an area of investigative techniques and investigative approaches, not only on our side, but on the independent counsel's. Independent counsel is well aware of Mr. Gilliam, and I'd like to leave it at that if I may.

Senator Graham. We'll defer further questions in that area.

Mr. Keating, I alluded to some budget figures that we had had which indicated that there'd been a large volume of HUD referrals to the Department of Justice beginning in the early 1980's. Up until 1988, there did not appear, at least in terms of number of personnel, a significant commitment to these HUD cases. How would you compare the relationship of HUD to the Department of Justice, let's say, in the prior administration and since Secretary Kemp has been the leader of the Department?

Mr. **Keating.** Mr. Chairman, I can say early in the prior administration, I was U.S. Attorney in Tulsa, Oklahoma, and we had obviously a number of programmatic cases involving a number of cabinet departments to consider. I believe we had some HUD cases and there was no trouble with getting to them at the local level, and we didn't have to ask for help from Washington.

Since I came aboard as Secretary Kemp's General Counsel, and since we examined the cases that we identified with the closing agents, the Marilyn Harrel incident, for example, we found the Justice Department's commitment to us to be outstanding. The Attorney General's commitment to make these cases move to be superb and real commitment. And Secretary Kemp was very pleased with the cooperation he's received from the Attorney General, from all the components of justice.

I might give an example. In the closing agent cases we referred, Mr. Chairman, again, the Maryilyn Harrel ties, we referred 11 cases. Of those 11, Washington, D.C.: conviction, 46 months in prison and a plea or guilty; $600,000 in restitution. Montgomery, Alabama: 5 years in prison, $2 million fine, $2,073,000 restitution to HUD, $25,000 restitution to the IRS. Arlington, Texas: conviction, 6.5 years in prison, 5 years probation, 500 hours community service. Indianapolis: indicted May 8, 1990; sentencing scheduled June 29. Indianapolis: indicted May 2, 1990; sentencing scheduled July 25. Atlanta: indicted April 26, 1990; civil suit filed for recovery of funds. Birmingham, Alabama: 5 years probation; conviction; and 4 open cases.

We think, again, those are the criminal cases that we identified when we came aboard. Marilyn Harrel, obviously the most stellar example of that, but those were 11 criminal cases, closing agent cases, 7 promptly disposed of, significant recoveries and sentences and 4 cases pending.

We have, as I've indicated previously, 18 asset recovery strike force cases which we've referred and which we are working with the Justice Department on now. We've recovered nearly $6 million. We referred another 40 cases to the Justice Department, and as far as we know, again, I know from my operation, they are moving expeditiously and professionally.

I'm satisfied with the manner in which these cases are being handled.

Senator Graham. If the statistics that we've been provided are accurate, that is, that there was an average of 200 cases referred from HUD to the Department of Justice between the years 1982 and 1988, that would indicate approximately 1,200 to 1,400 cases during that time period. As supplement to the record, could we get an analysis of what happened to those 1,200 to 1,400 cases: how many of them were dismissed due to inadequate information for prosecution, how many were prosecuted, and what the consequence of those prosecutions were?

Mr. **Maloney.** Mr. Chairman, we'll do our best to try to retrieve that data. It may be difficult to identify HUD cases specifically going back that far, but we will do our best to provide the best information that we have.

Senator Graham. Gentlemen, I want to thank you very much for your assistance to the Subcommittee. You are the final panel of this subcommittee's hearing. We end it at a very professional level, and I commend you for each of your individual efforts to see that the residue of a period of failure of public trust is dealt with in an appropriate manner. Thank you very much.

Mr. **Maloney.** Thank you, Mr. Chairman.

Senator Graham. The hearing is over with.

[Whereupon, at 12:28 p.m., the hearing was adjourned.]

[Response to written questions follows:]

DONALD W. RIEGLE, JR., MICHIGAN, CHAIRMAN

ALAN CRANSTON, CALIFORNIA
PAUL S. SARBANES, MARYLAND
CHRISTOPHER J. DODD, CONNECTICUT
ALAN J. DIXON, ILLINOIS
JIM SASSER, TENNESSEE
TERRY SANFORD, NORTH CAROLINA
RICHARD C. SHELBY, ALABAMA
BOB GRAHAM, FLORIDA
TIMOTHY E. WIRTH, COLORADO
JOHN F. KERRY, MASSACHUSETTS
RICHARD H. BRYAN, NEVADA

JAKE GARN, UTAH
JOHN HEINZ, PENNSYLVANIA
ALFONSE M. D'AMATO, NEW YORK
PHIL GRAMM, TEXAS
CHRISTOPHER S. BOND, MISSOURI
CONNIE MACK, FLORIDA
WILLIAM V. ROTH, JR., DELAWARE
NANCY LANDON KASSEBAUM, KANSAS
LARRY PRESSLER, SOUTH DAKOTA

STEVEN B. HARRIS, STAFF DIRECTOR AND CHIEF COUNSEL
LAMAR SMITH, REPUBLICAN STAFF DIRECTOR AND ECONOMIST

United States Senate
COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS
WASHINGTON, DC 20510-6075

July 9, 1990

Mr. Paul Adams
Inspector General
U.S. Department of Housing and
Urban Development
451 Seventh Street, S.W.
Washington, D.C. 20410

Dear Mr. Adams:

I wish to thank you again for your insightful testimony at our June 29th hearing. As usual, your report and its recommendations will prove very useful to the Subcommittee in its deliberations. It is also our hope that, in the future, you will be provided the opportunity to present your semiannual reports to the Senate at a hearing dedicated to that purpose. I also ask that you pass on my thanks and appreciation to your staff who provided the Subcommittee with invaluable assistance in preparing for the hearing.

During the hearing, other questions emerged to which I would like to obtain supplemental information for the record. These questions are the following:

1. Your testimony discussed the problems which ensued when consultants or project sponsors were permitted to appeal field decisions to headquarters. This occurred in the Title X and Retirement Service Center programs, for example. In your view, was the problem in the opportunity for headquarters to overrule field decisions, or in the manner in which the appeal process was undertaken? How do the current appeal processes at HUD differ, if at all, with those of the previous Administration, either in the circumstances under which an appeal is allowed or with the procedure itself? (See page 26 of your copy of the transcript for a discussion of this topic.)

2. At the hearing, you highlighted problems concerning the relationship between Public Housing Authorities (PHAs) and nonprofit Housing Development Corporations (HDCs), specifically recommending that HUD look into developing regulations to better define this relationship. You stated that HUD, in its response to your recommendations, suggested that the authority already existed in current regulations. Could you please

provide the Subcommittee with a copy of your correspondence with HUD on this issue including HUD's response, and a copy of the regulations to which you referred? Have you had an opportunity to review those regulations and do you agree with HUD's assessment? Regardless of the authority of HUD to regulate HDCs, what form should that regulation take, in your opinion? (See page 28 of the transcript for a discussion of this topic.)

3. Regarding the Title X program, you stated that six projects which you examined were referred to your Office of Investigations for further follow-up. The Subcommittee would appreciate some details on these six projects. For example, which projects were these? Why did you feel the need to investigate them further? What is the status of the investigation? Is your office investigating this on its own or in conjunction with the FBI? (See pages 28-29 of the transcript for discussion of this topic.)

Inasmuch as the Subcommittee is currently working to complete its report by late summer, your responses to these questions are needed by July 19, 1990. If you have any problems or concerns with my request, please feel free to contact Janet Mascia of the Subcommittee's staff on 224-6094.

Once again, please accept my appreciation for making this hearing a successful one and for your help over these many months.

Sincerely,

Bob Graham

Bob Graham
Chairman
HUD/Mod Rehab Investigation
Subcommittee

U.S. Department of Housing and Urban Development
Washington, D.C. 20410-4500

OFFICE OF INSPECTOR GENERAL

July 20, 1990

Honorable Bob Graham
Chairman, HUD/Moderate Rehabilitation
  Investigation Subcommittee
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510-6075

Dear Mr. Chairman:

This is in response to your request of July 9, 1990, for supplemental information regarding questions that emerged during the hearing on June 29, 1990. Enclosure A contains the answers to your specific questions. Enclosures B, C, and D provide copies of documents relating to Question 2.

Should your staff have any further questions, please have them contact John J. Connors, Deputy Inspector General. He can be reached on 708-0430.

Sincerely,

Paul A. Adams
Inspector General

Enclosures (4)

Enclosure A
Page 1 of 3

Responses to Questions from Senator Bob Graham
Chairman, HUD/Mod Rehab
Investigation Subcommittee

Question #1:

At the hearing, you discussed the problems which ensued when consultants or project sponsors were permitted to appeal Field decisions to Headquarters. This occurred in the Title X and Retirement Service Center Programs.

1A. In your view, was the problem in the opportunity for Headquarters to overrule Field decisions, or in the manner in which the appeal process was undertaken?

Response: In our opinion, the Department's appeal process was not deficient. Essentially, the Headquarters technical staff reevaluated the application using the same standards as the Field staff used to determine if the Field staff misinterpreted or disregarded the underwriting standards. In most cases, Headquarters technical staff substantiated the conclusions from the Field staff. The real problem in the process started when HUD management, on several occasions, rejected the technical underwriting determinations and substituted subjective determinations to overrule the Field. Moreover, HUD Headquarters rationale for overturning Field determinations was unclear because documentation was incomplete or missing from the files.

1B. How do the current appeal processes at HUD differ, if at all, with those of the previous Administration, either in the circumstances under which an appeal is allowed or with the procedure itself?

Response: Recently, the current Administration modified procedures so that HUD Regional Office technical staff evaluates the sponsor's application before it is sent to HUD Headquarters staff. It is intended that Regional Offices will make final decisions for programs under their control.

Question #2:

At the hearing, you highlighted problems concerning the relationship between Public Housing Authorities (PHAs) and nonprofit Housing Development Corporations (HDCs), specifically recommending that HUD look into developing regulations to better define this relationship. You stated that HUD, in its response to your recommendations, suggested that the authority already existed in current regulations.

2A. Could you please provide the Subcommittee with a copy of your correspondence with HUD on this issue, including HUD's response, and a copy of the regulations to which you referred?

Response: Enclosure B includes a copy of our correspondence with HUD and HUD's response to our report. Enclosures C and D contain the documents referred to in their response. As the Office of Public and Indian Housing indicated in their response, the listing is incomplete for certain matters and further research is needed.

2B. Have you had an opportunity to review those regulations and do you agree with HUD's assessment?

Response: As noted, work is still underway to identify all pertinent regulations. Upon review of the entire set of regulations, we will make a determination on the adequacy of HUD's assessment.

2C. Regardless of the authority of HUD to regulate HDCs, what form should that regulation take, in your opinion?

Response: In our opinion, HUD regulations should provide sufficient controls over HDC operations to ensure that HUD programs and PHA financial stability are adequately protected. For example, regulations should control: inappropriate resource allocation; conflict-of-interest situations, and inequitable treatment of tenants. Further, PHAs should be required to include HDCs in their annual audits in accordance with OMB Circular A-128, the Single Audit Act.

Enclosure A
Page 3 of 3

Question #3:

Regarding the Title X program, you stated that six projects which you examined were referred to your Office of Investigation for further follow-up. The Subcommittee would appreciate some details on these six projects. For example, which projects were these? Why did you feel the need to investigate them further? What is the status of the investigation? Is your Office investigating this on its own or in conjunction with the FBI?

Response: Each project is listed in the following paragraphs.

Project: Gingerwood Title X Project
Location: Wilmington, North Carolina
Status: FBI and OIG are investigating this case.

Project: Hidden Woods Title X Project
Location: Memphis, Tennessee
Status: OIG is investigating this case.

Project: Hickory Hills Title X Project
Location: Mount Juliet, Tennessee
Status: FBI and OIG are investigating this case.

Project: Cumberland II Title X Development
Location: Houston, Texas
Status: OIG is investigating this case.

Project: Southcreek Title X Development
Location: Dallas, Texas
Status: FBI and OIG are investigating this case.

Project: Steeds Crossing Title X Project
Location: Austin, Texas
Status: FBI and OIG are investigating this case.

Project: Autumn Meadows Title X Project
Location: Fort Worth, Texas
Status: FBI and OIG are investigating this case.

These investigations were based on audit results indicating the possibility that the projects may have been approved as a result of the use of consultants and/or the decisions of Headquarters officials to override the objections of Field Office personnel.

Copies of our files concerning these investigations were provided for review to the Criminal Division of the Department of Justice.

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-4500

OFFICE OF INSPECTOR GENERAL

Enclosure B
Page1 of 7

July 2, 1990

MEMORANDUM FOR: Joseph H. Sens, Director, Office of Finance and Management, PF

Peter Bell for

FROM: Jim Heist, Acting Director, Independent Auditor Monitoring and Follow-up, ZASM

SUBJECT: Audit Follow-up: Survey of PHA's Housing Development Corporation (90-TS-108-0007)

This is in response to your memorandum of June 28, 1990 on the subject report. We have reviewed your response and concur with your action plan. We have established a target date of September 30, 1990 for you to issue the HUD Notice. This applies to all four recommendations (1A, 1B, 1C, 1D) in the report.

Should you have any questions, please contact Watt Sammons on 708-0383.

WASHINGTON, D.C. 20410

OFFICE OF THE ASSISTANT SECRETARY
FOR PUBLIC AND INDIAN HOUSING

JUN 28 1990

MEMORANDUM FOR: Dale C. Williams, Director, Independent
Audit Monitoring and Follow-up, ZASM

JHSens

FROM: Joseph H. Sens, Director, Office of Finance and
Management, PF

SUBJECT: Audit Follow-up: Survey of PHAs' Housing Development
Corporation (90-TS-108-007)

Relative to the subject OIG audit report, the General Deputy Assistant Secretary for Public and Indian Housing (PIH) has issued the following plan of action for implementing and completing OIG recommendations with a target date of September 30, 1990:

> "Issue HUD Notice on requirements and procedures regarding PHA-HDC transactions involving the Public Housing Program in areas of: (1) encumbrance of public housing assets; (2) allocation of costs among Public Housing Program and HDC Programs; and (3) PHA-HDC contracts that affect the Public Housing Program. Applicable to PHAs and IHAs."

Attached for your information, is a copy of Mr. Janis' Memorandum to Mr. DelliBovi relevant to the subject.

Attachment

OFFICE OF THE ASSISTANT SECRETARY
FOR PUBLIC AND INDIAN HOUSING

MAY 31 1990

MEMORANDUM FOR: Alfred A. DelliBovi, Under Secretary, U

FROM: Michael B. Janis, General Deputy Assistant Secretary, PD

SUBJECT: Information: Material Weakness Action Plan -- PHA-HDC abuses

This responds to your May 3, 1990, memorandum regarding the April 2, 1990, report of the Office of Inspector General (OIG), on the subject of abuses in the operations of Public Housing Agencies (PHAs) and their related Housing Development Corporations (HDCs). That report identified HUD's lack of controls over transactions between PHAs and related HDCs as a material weakness, and your memorandum directed this office to submit for your approval an action plan for correcting the material weakness. (Our references to PHAs and the Public Housing Program are meant to include IHAs and their Indian Housing Programs that are subject to the public housing provisions of the United States Housing Act of 1937.)

Based on advice from the Office of Management and Quality Assurance (OMQA), we believe that our attached recommendation for the corrective action data to be added to the OMQA form will be satisfactory to that office. If OMQA should have any questions about this, I suggest that Wayne Hunter of my staff be contacted (708-0713).

As we see the matter, the abuses cited by the OIG, as relevant to the Public Housing Program, fall into three categories, as follows:

1. PHA-HDC transactions that violate the covenant against encumbrance of public housing assets, as stated in the Annual Contributions Contract (ACC).

2. Inequitable allocation of costs, as between the PHA's Public Housing Program and the operations of the HDC, in violation of existing financial management handbook requirements.

3. PHA-HDC contracts that are contrary to the provisions of law, the ACC, and regulations that govern procurement for the Public Housing Program.

We believe that, for the first two categories, existing regulatory requirements clearly prohibit abuses of the types cited in the OIG report, in a way that provides a firm basis for HUD enforcement. Our present assessment of the third category of abuses -- regarding PHA-HDC contracts -- is that existing laws and regulations (including the fundamental regulatory provisions of the ACC) also contain established prohibitions that are probably a sufficient basis for enforcement. Nevertheless, further consultation with the Office of General Counsel (OGC) and Office of Inspector General (OIG) will be necessary to confirm our assessment of that third category.

Subject to that further consultation, it appears that the nub of the problem is not a lack of existing regulatory prohibitions, but effective enforcement of those prohibitions. We believe that corrective actions should focus on emphasizing the existing requirements (including clarification about their specific application to PHA-HDC transactions) and improving program controls for monitoring and enforcement.

As stated in our attached recommendation for the corrective action to be added to the OMQA report, this would be accomplished by publication of a new HUD Notice for PHAs and HUD staff, covering each of the three categories of abuses in the specific context of PHA-HDC transactions that involve PHA public housing operations.

Our recommendations go only to matters affecting the Public Housing Program. Some of the OIG findings relate to abuses that appear to be limited to Section 8 programs, without any impact on the Public Housing Program. An example is the case (cited on page 5 of the OIG report) where the Housing Authority of the City of Los Angeles set aside Section 8 certificates for a project owned by its related HDC. Such Section 8 abuses should be addressed by the Office of Housing. We are sending a separate memorandum on that subject to OIG, with copy to Housing.

I believe that this action plan accurately reflects the material weakness in the Public Housing Program; that the corrective action will solve the problem; and the corrective action can be implemented within the proposed schedule. That statement is subject to our recognition that issuance of program instructions cannot, of itself, solve problems in program administration, and that solution requires actual field implementation of provisions of the forthcoming Notice, as a part of our ongoing responsibilities for instruction, technical assistance, monitoring and compliance.

Attachment

Addition to OMCA Material Weakness Report Form : Material Weakness 90-2

PHAs' Housing Development Corporations

A. Issue HUD Notice on requirements and procedures regarding PHA-HDC transactions involving the Public Housing Program, in areas of : (1) encumbrance of public housing assets; (2) allocation of costs among Public Housing Program and HDC programs; and (3) PHA-HDC contracts that affect the Public Housing Program. Applicable to PHAs and IHAs.

New

EDC: 09/30/90

Contact
Name/Phone Nancy Chisholm (202) 755-6713

THE UNDER SECRETARY
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-0050

May 3, 1990

MEMORANDUM FOR: Michael B. Janis, General Deputy Assistant Secretary for Public and Indian Housing, P

FROM: Alfred A. DelliBovi, Under Secretary, U Alfred A. DelliBovi

SUBJECT: Material Weakness in Public and Indian Housing

On April 2, 1990, the Office of Inspector General issued the attached report concerning Public Housing Authorities' (PHAs) establishment of Housing Development Corporations (HDCs). That report identifies HUD's lack of internal controls over PHAs' establishment and operation of HDCs as a material weakness which should be disclosed in HUD's FMFIA Assurance Statement. The report also recommends actions to correct the weakness.

Please submit your action plan for correcting this material weakness to me for approval by May 25, 1990, with a copy to the Office of Management and Quality Assurance (OMQA). The action plan should follow the format of the Secretary's Management Report on Material Weaknesses, including estimated completion dates and contact names and phone numbers.

Please include the following statement at the bottom of your action plan: "I believe that this action plan accurately reflects the material weakness in the program; that the corrective actions will solve the problem; and that the corrective actions can be implemented within the proposed schedule." Your signature and the date should follow.

Following my approval of the action plan, OMQA will include the material weakness in the Secretary's Management Report on Material Weaknesses and you will be asked to update the information on a monthly basis.

If you have any questions, please contact Hal Henry on 755-1027.

Attachment

§ 85.36 Procurement.

(a) *States.* When procuring property and services under a grant, a State will follow the same policies and procedures it uses for procurements from its non-Federal funds. The State will ensure that every purchase order or other contract includes any clauses required by Federal statutes and executive orders and their implementing regulations. Other grantees and subgrantees will follow paragraphs (b) through (i) in this section.

(b) *Procurement standards.* (1) Grantees and subgrantees will use their own procurement procedures which reflect applicable State and local laws and regulations, provided that the procurements conform to applicable Federal law and the standards identified in this section.

(2) Grantees and subgrantees will maintain a contract administration system which ensures that contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders.

(3) Grantees and subgrantees will maintain a written code of standards of conduct governing the performance of their employees engaged in the award and administration of contracts. No employee, officer or agent of the grantee or subgrantee shall participate in selection, or in the award or administration of a contract supported by Federal funds if a conflict of interest, real or apparent, would be involved. Such a conflict would arise when:

(i) The employee, officer or agent,

(ii) Any member of his immediate family,

(iii) His or her partner, or

(iv) An organization which employs, or is about to employ, any of the above, has a financial or other interest in the firm selected for award. The grantee's or subgrantee's officers, employees or agents will neither solicit nor accept gratuities, favors or anything of monetary value from contractors, potential contractors, or parties to subagreements. Grantee and subgrantees may set minimum rules where the financial interest is not substantial or the gift is an unsolicited item of nominal intrinsic value. To the extent permitted by State or local law or regulations, such standards or conduct will provide for penalties, sanctions, or other disciplinary actions for violations of such standards by the grantee's and subgrantee's officers, employees, or agents, or by contractors or their agents. The awarding agency may in regulation provide additional prohibitions relative to real, apparent, or potential conflicts of interest.

(4) Grantee and subgrantee procedures will provide for a review of proposed procurements to avoid purchase of unnecessary or duplicative items. Consideration should be given to consolidating or breaking out procurements to obtain a more economical purchase. Where appropriate, an analysis will be made of lease versus purchase alternatives, and any other appropriate analysis to determine the most economical approach.

(5) To foster greater economy and efficiency, grantees and subgrantees are encouraged to enter into State and local intergovernmental agreements for procurement or use of common goods and services.

(6) Grantees and subgrantees are encouraged to use Federal excess and surplus property in lieu of purchasing new equipment and property whenever such use is feasible and reduces project costs.

(7) Grantees and subgrantees are encouraged to use value engineering clauses in contracts for construction projects of sufficient size to offer reasonable opportunities for cost reductions. Value engineering is a systematic and creative anaylsis of each contract item or task to ensure that its essential function is provided at the overall lower cost.

(8) Grantees and subgrantees will make awards only to responsible contractors possessing the ability to perform successfully under the terms and conditions of a proposed procurement. Consideration will be given to such matters as contractor integrity, compliance with public policy, record of past performance, and financial and technical resources.

(9) Grantees and subgrantees will maintain records sufficient to detail the significant history of a procurement. These records will include, but are not necessarily limited to the fol-

lowing: rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price.

(10) Grantees and subgrantees will use time and material type contracts only—

(i) After a determination that no other contract is suitable, and

(ii) If the contract includes a ceiling price that the contractor exceeds at its own risk.

(11) Grantees and subgrantees alone will be responsible, in accordance with good administrative practice and sound business judgment, for the settlement of all contractual and administrative issues arising out of procurements. These issues include, but are not limited to source evaluation, protests, disputes, and claims. These standards do not relieve the grantee or subgrantee of any contractual responsibilities under its contracts. Federal agencies will not substitute their judgment for that of the grantee or subgrantee unless the matter is primarily a Federal concern. Violations of law will be referred to the local, State, or Federal authority having proper jurisdiction.

(12) Grantees and subgrantees will have protest procedures to handle and resolve disputes relating to their procurements and shall in all instances disclose information regarding the protest to the awarding agency. A protestor must exhaust all administrative remedies with the grantee and subgrantee before pursuing a protest with the Federal agency. Reviews of protests by the Federal agency will be limited to:

(i) Violations of Federal law or regulations and the standards of this section (violations of State or local law will be under the jurisdiction of State or local authorities) and

(ii) Violations of the grantee's or subgrantee's protest procedures for failure to review a complaint or protest. Protests received by the Federal agency other than those specified above will be referred to the grantee or subgrantee.

(c) *Competition.* (1) All procurement transactions will be conducted in a manner providing full and open competition consistent with the standards of § 85.36. Some of the situations considered to be restrictive of competition include but are not limited to:

(i) Placing unreasonable requirements on firms in order for them to qualify to do business,

(ii) Requiring unnecessary experience and excessive bonding,

(iii) Noncompetitive pricing practices between firms or between affiliated companies,

(iv) Noncompetitive awards to consultants that are on retainer contracts,

(v) Organizational conflicts of interest,

(vi) Specifying only a "brand name" product instead of allowing "an equal" product to be offered and describing the performance of other relevant requirements of the procurement, and

(vii) Any arbitrary action in the procurement process.

(2) Grantees and subgrantees will conduct procurements in a manner that prohibits the use of statutorily or administratively imposed in-State or local geographical preferences in the evaluation of bids or proposals, except in those cases where applicable Federal statutes expressly mandate or encourage geographic preference. Nothing in this section preempts State licensing laws. When contracting for architectural and engineering (A/E) services, geographic location may be a selection criteria provided its application leaves an appropriate number of qualified firms, given the nature and size of the project, to compete for the contract.

(3) Grantees will have written selection procedures for procurement transactions. These procedures will ensure that all solicitations:

(i) Incorporate a clear and accurate description of the technical requirements for the material, product, or service to be procured. Such description shall not, in competitive procurements, contain features which unduly restrict competition. The description may include a statement of the qualitative nature of the material, product or service to be procured, and when necessary, shall set forth those minimum essential characteristics and standards to which it must conform if it is to satisfy its intended use. Detailed product specifications should be avoided if at all possible. When it is impractical or uneconomical to make a clear and accurate description of the technical requirements, a "brand name or equal" description may be used as a means to define the performance or other salient requirements of a procurement. The specific features of the named brand which must be met by offerors shall be clearly stated; and

(ii) Identify all requirements which the offerors must fulfill and all other factors to be used in evaluating bids or proposals.

(4) Grantees and subgrantees will ensure that all prequalified lists of persons, firms, or products which are used in acquiring goods and services are current and include enough qualified sources to ensure maximum open and free competition. Also, grantees and subgrantees will not preclude potential bidders from qualifying during the solicitation period.

(d) *Methods of procurement to be followed*—(1) *Procurement by small purchase procedures.* Small purchase procedures are those relatively simple and informal procurement methods for securing services, supplies, or other property that do not cost more than $25,000 in the aggregate. If small purchase procurements are used, price or rate quotations will be obtained from an adequate number of qualified sources.

(2) Procurement by *sealed bids* (formal advertising). Bids are publicly solicited and a firm-fixed-price contract (lump sum or unit price) is awarded to the responsible bidder whose bid, conforming with all the material terms and conditions of the invitation for bids, is the lowest in price. The sealed bid method is the preferred method for procuring construction, if the conditions in § 85.36(d)(2)(i) apply.

(i) In order for sealed bidding to be feasible, the following conditions should be present:

(A) A complete, adequate, and realistic specification or purchase description is available;

(B) Two or more responsible bidders are willing and able to compete effectively for the business; and

(C) The procurement lends itself to a firm fixed price contract and the selection of the successful bidder can be made principally on the basis of price.

(ii) If sealed bids are used, the following requirements apply:

(A) The invitation for bids will be publicly advertised and bids shall be solicited from an adequate number of known suppliers, providing them sufficient time prior to the date set for opening the bids;

(B) The invitation for bids, which will include any specifications and pertinent attachments, shall define the items or services in order for the bidder to properly respond;

(C) All bids will be publicly opened at the time and place prescribed in the invitation for bids;

(D) A firm fixed-price contract award will be made in writing to the lowest responsive and responsible bidder. Where specified in bidding documents, factors such as discounts, transportation cost, and life cycle costs shall be considered in determining which bid is lowest. Payment discounts will only be used to determine the low bid when prior experience indicates that such discounts are usually taken advantage of; and

(E) Any or all bids may be rejected if there is a sound documented reason.

(3) Procurement by *competitive proposals.* The technique of competitive proposals is normally conducted with more than one source submitting an offer, and either a fixed-price or cost-reimbursement type contract is awarded. It is generally used when conditions are not appropriate for the use of sealed bids. If this method is used, the following requirements apply:

(i) Requests for proposals will be publicized and identify all evaluation factors and their relative importance. Any response to publicized requests for proposals shall be honored to the maximum extent practical;

(ii) Proposals will be solicited from an adequate number of qualified sources;

(iii) Grantees and subgrantees will have a method for conducting technical evaluations of the proposals received and for selecting awardees;

(iv) Awards will be made to the responsible firm whose proposal is most advantageous to the program, with price and other factors considered; and

(v) Grantees and subgrantees may use competitive proposal procedures for qualifications-based procurement of architectural/engineering (A/E) professional services whereby competitors' qualifications are evaluated and the most qualified competitor is selected, subject to negotiation of fair and reasonable compensation. The method, where price is not used as a selection factor, can only be used in procurement of A/E professional services. It cannot be used to purchase other types of services though A/E firms are a potential source to perform the proposed effort.

(4) Procurement by *noncompetitive proposals* is procurement through solicitation of a proposal from only one source, or after solicitation of a number of sources, competition is determined inadequate.

(i) Procurement by noncompetitive proposals may be used only when the award of a contract is infeasible under small purchase procedures, sealed bids or competitive proposals and one of the following circumstances applies:

(A) The item is available only from a single source;

(B) The public exigency or emergency for the requirement will not permit a delay resulting from competitive solicitation.

(C) The awarding agency authorizes noncompetitive proposals; or

(D) After solicitation of a number of sources, competition is determined inadequate.

(ii) Cost analysis, i.e., verifying the proposed cost data, the projections of the data, and the evaluation of the specific elements of costs and profit, is required.

(iii) Grantees and subgrantees may be required to submit the proposed procurement to the awarding agency for pre-award review in accordance with paragraph (g) of this section.

(e) *Contracting with small and minority firms, women's business enterprise and labor surplus area firms.* (1) The grantee and subgrantee will take all necessary affirmative steps to assure that minority firms, women's business enterprises, and labor surplus area firms are used when possible.

(2) Affirmative steps shall include:

(i) Placing qualified small and minority businesses and women's business enterprises on solicitation lists;

(ii) Assuring that small and minority businesses, and women's business enterprises are solicited whenever they are potential sources;

(iii) Dividing total requirements, when economically feasible, into smaller tasks or quantities to permit maximum participation by small and minority business, and women's business enterprises;

(iv) Establishing delivery schedules, where the requirement permits, which encourage participation by small and minority business, and women's business enterprises;

(v) Using the services and assistance of the Small Business Administration, and the Minority Business Development Agency of the Department of Commerce; and

(vi) Requiring the prime contractor, if subcontracts are to be let, to take the affirmative steps listed in paragraphs (e)(2) (i) through (v) of this section.

(f) *Contract cost and price.* (1) Grantees and subgrantees must perform a cost or price analysis in connection with every procurement action including contract modifications. The method and degree of analysis is dependent on the facts surrounding the particular procurement situation, but as a starting point, grantees must make independent estimates before receiving bids or proposals. A cost analysis must be performed when the offeror is required to submit the elements of his estimated cost, e.g., under professional, consulting, and architectural engineering services contracts. A cost analysis will be necessary when adequate price competition is lacking, and for sole source procurements, including contract modifications or change orders, unless price resonableness can be established on the basis of a catalog or market price of a commercial product sold in substantial quantities to the general public or based on prices set by law or regulation. A price analysis will be used in all other instances to determine the reasonableness of the proposed contract price.

(2) Grantees and subgrantees will negotiate profit as a separate element

of the price for each contract in which there is no price competition and in all cases where cost analysis is performed. To establish a fair and reasonable profit, consideration will be given to the complexity of the work to be performed, the risk borne by the contractor, the contractor's investment, the amount of subcontracting, the quality of its record of past performance, and industry profit rates in the surrounding geographical area for similar work.

(3) Costs or prices based on estimated costs for contracts under grants will be allowable only to the extent that costs incurred or cost estimates included in negotiated prices are consistent with Federal cost principles (see § 85.22). Grantees may reference their own cost principles that comply with the applicable Federal cost principles.

(4) The cost plus a percentage of cost and percentage of construction cost methods of contracting shall not be used.

(g) *Awarding agency review.* (1) Grantees and subgrantees must make available, upon request of the awarding agency, technical specifications on proposed procurements where the awarding agency believes such review is needed to ensure that the item and/or service specified is the one being proposed for purchase. This review generally will take place prior to the time the specification is incorporated into a solicitation document. However, if the grantee or subgrantee desires to have the review accomplished after a solication has been developed, the awarding agency may still review the specifications, with such review usually limited to the technical aspects of the proposed purchase.

(2) Grantees and subgrantees must on request make available for awarding agency pre-award review [delete ","] procurement documents, such as requests for proposals or invitations for bids, independent cost estimates, etc., when:

(i) A grantee's or subgrantee's procurement procedures or operation fails to comply with the procurement standards in this seciton; or

(ii) The procurement is expected to exceed $25,000 and is to be awarded without competition or only one bid or offer is received in response to a solicitation; or

(iii) The procurement, which is expected to exceed $25,000, specifies a "brand name" product; or

(iv) The proposed award over $25,000 is to be awarded to other than the apparent low bidder under a sealed bid procurement; or

(v) A proposed contract modification changes the scope of a contract or increases the contract amount by more than $25,000.

(3) A grantee or subgrantee will be exempt from the pre-award review in paragraph (g)(2) of this section if the awarding agency determines that its procurement systems comply with the standards of this section.

(i) A grantee or subgrantee may request that its procurement system be reviewed by the awarding agency to determine whether its system meets these standards in order for its system to be certified. Generally, these reviews shall occur where there is a continuous high-dollar funding, and third-party contracts are awarded on a regular basis;

(ii) A grantee or subgrantee may self-certify its procurement system. Such self-certification shall not limit the awarding agency's right to survey the system. Under a self-certification procedure, awarding agencies may wish to rely on written assurances from the grantee or subgrantee that it is complying with these standards. A grantee or subgrantee will cite specific procedures, regulations, standards, etc., as being in compliance with these requirements and have its system available for review.

(h) *Bonding requirements.* For construction or facility improvement contracts or subconstracts exceeding $100,000, the awarding agency may accept the bonding policy and requirements of the grantee or subgrantee provided the awarding agency has made a determination that the awarding agency's interest is adequately protected. If such a determination has not been made, the minimum requirements shall be as follows:

(1) *A bid guarantee from each bidder equivalent to five percent of the bid price.* The "bid guarantee" shall consist of a firm commitment such as a

bid bond, certified check, or other negotiable instrument accompanying a bid as assurance that the bidder will, upon acceptance of his bid, execute such contractual documents as may be required within the time specified.

(2) *A performance bond on the part of the contractor for 100 percent of the contract price.* A "performance bond" is one executed in connection with a contract to secure fulfillment of all the contractor's obligations under such contract.

(3) *A payment bond on the part of the contractor for 100 percent of the contract price.* A "payment bond" is one executed in connection with a contract to assure payment as required by law of all persons supplying labor and material in the execution of the work provided for in the contract.

(i) *Contract provisions.* A grantee's and subgrantee's contracts must contain provisions in paragraph (i) of this section. Federal agencies are permitted to require changes, remedies, changed conditions, access and records retention, suspension of work, and other clauses approved by the Office of Procurement Policy.

(1) Administrative, contractual, or legal remedies in instances where contractors violate or breach contract terms, and provide for such sanctions and penalties as may be appropriate. (Contracts other than small purchases)

(2) Termination for cause and for convenience by the grantee or subgrantee including the manner by which it will be effected and the basis for settlement. (All contracts in excess of $10,000)

(3) Compliance with Executive Order 11246 of September 24, 1965 entitled "Equal Employment Opportunity," as amended by Executive Order 11375 of October 13, 1967 and as supplemented in Department of Labor regulations (41 CFR Chapter 60). (All construction contracts awarded in excess of $10,000 by grantees and their contractors or subgrantees)

(4) Compliance with the Copeland "Anti-Kickback" Act (18 U.S.C. 874) as supplemented in Department of Labor regulations (29 CFR Part 3). (All contracts and subgrants for construction or repair)

(5) Compliance with the Davis-Bacon Act (40 U.S.C. 276a to a-7) as supplemented by Department of Labor regulations (29 CFR Part 5). (Construction contracts in excess of $2,000 awarded by grantees and subgrantees when required by Federal grant program legislation)

(6) Compliance with Sections 103 and 107 of the Contract Work Hours and Safety Standards Act (40 U.S.C. 327-330) as supplemented by Department of Labor regulations (29 CFR Part 5). (Construction contracts awarded by grantees and subgrantees in excess of $2,000, and in excess of $2,500 for other contracts which involve the employment of mechanics or laborers)

(7) Notice of awarding agency requirements and regulations pertaining to reporting.

(8) Notice of awarding agency requirements and regulations pertaining to patent rights with respect to any discovery or invention which arises or is developed in the course of or under such contract.

(9) Awarding agency requirements and regulations pertaining to copyrights and rights in data.

(10) Access by the grantee, the subgrantee, the Federal grantor agency, the Comptroller General of the United States, or any of their duly authorized representatives to any books, documents, papers, and records of the contractor which are directly pertinent to that specific contract for the purpose of making audit, examination, excerpts, and transcriptions.

(11) Retention of all required records for three years after grantees or subgrantees make final payments and all other pending matters are closed.

(12) Compliance with all applicable standards, orders, or requirements issued under section 306 of the Clear Air Act (42 U.S.C. 1857(h)), section 508 of the Clean Water Act (33 U.S.C. 1368), Executive Order 11738, and Environmental Protection Agency regulations (40 CFR Part 15). (Contracts, subcontracts, and subgrants of amounts in excess of $100,000)

(13) Mandatory standards and policies relating to energy efficiency which are contained in the state

energy conservation plan issued in compliance with the Energy Policy and Conservation Act (Pub. L. 94-163).

§ 85.37 Subgrants.

(a) *States.* States shall follow state law and procedures when awarding and administering subgrants (whether on a cost reimbursement or fixed amount basis) of financial assistance to local and Indian tribal governments. States shall:

(1) Ensure that every subgrant includes any clauses required by Federal statute and executive orders and their implementing regulations;

(2) Ensure that subgrantees are aware of requirements imposed upon them by Federal statute and regulation;

(3) Ensure that a provision for compliance with § 85.42 is placed in every cost reimbursement subgrant; and

(4) Conform any advances of grant funds to subgrantees substantially to the same standards of timing and amount that apply to cash advances by Federal agencies.

(b) *All other grantees.* All other grantees shall follow the provisions of this part which are applicable to awarding agencies when awarding and administering subgrants (whether on a cost reimbursement or fixed amount basis) of financial assistance to local and Indian tribal governments. Grantees shall:

(1) Ensure that every subgrant includes a provision for compliance with this part;

(2) Ensure that every subgrant includes any clauses required by Federal statute and executive orders and their implementing regulations; and

(3) Ensure that subgrantees are aware of requirements imposed upon them by Federal statutes and regulations.

(c) *Exceptions.* By their own terms, certain provisions of this part do not apply to the award and administration of subgrants:

(1) Section 85.10;

(2) Section 85.11;

(3) The letter-of-credit procedures specified in Treasury Regulations at 31 CFR Part 205, cited in § 85.21; and

(4) Section 85.50.

REPORTS, RECORDS, RETENTION, AND ENFORCEMENT

§ 85.40 Monitoring and reporting program performance.

(a) *Monitoring by grantees.* Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity.

(b) *Nonconstruction performance reports.* The Federal agency may, if it decides that performance information available from subsequent applications contains sufficient information to meet its programmatic needs, require the grantee to submit a performance report only upon expiration or termination of grant support. Unless waived by the Federal agency this report will be due on the same date as the final Financial Status Report.

(1) Grantees shall submit annual performance reports unless the awarding agency requires quarterly or semiannual reports. However, performance reports will not be required more frequently than quarterly. Annual reports shall be due 90 days after the grant year, quarterly or semi-annual reports shall be due 30 days after the reporting period. The final performance report will be due 90 days after the expiration or termination of grant support. If a justified request is submitted by a grantee, the Federal agency may extend the due date for any performance report. Additionally, requirements for unnecessary performance reports may be waived by the Federal agency.

(2) Performance reports will contain, for each grant, brief information on the following:

(i) A comparison of actual accomplishments to the objectives established for the period. Where the output of the project can be quantified, a computation of the cost per unit of output may be required if that information will be useful.

Enclosure D
Page 1 of 2

Sec. 312. Property Included in a Project

Each Project shall include (1) all real property or interest therein which is acquired and held in connection with such Project, together with all easements, rights-of-way, and all incorporeal hereditaments thereunto belonging or in anywise appertaining, and (2) all personal property, tangible and intangible, or interest therein which is acquired and held in connection with such Project, including (but not limited to) equipment and supplies, monies on hand and on deposit, reserves, securities, accounts receivable, choses in action, leases, contracts, books of account, papers, and records. All such property immediately upon acquisition (whether before or after issuance of the Actual Development Cost Certificate) by the Local Authority shall become a part of such Project and shall be subject to the terms, covenants, and conditions of this Contract: Provided, That if this Contract is terminated with respect to any Project and at such time any other Project or Projects are being administered pursuant to the provisions of this Contract, all reserves and Residual Receipts of such terminated Project accrued to the date of such termination and not theretofore applied to the purposes of this Contract shall, except as provided in Part One of this Contract, become a part of such other Project or Projects and shall continue to be subject to the terms, covenants, and conditions of this Contract.

Sec. 313. Covenant Against Conveyance or Encumbrance

Unless and until all Temporary Notes, Advance Notes, Permanent Notes, and all other indebtedness of the Local Authority to the Government arising under this Contract in connection with any Project have been fully paid, and all Bonds issued in connection with such Project have been fully paid and retired, or monies sufficient for the payment and retirement thereof have, in accordance with the terms of such Bonds, been deposited in trust for such purpose with the Fiscal Agent, the Local Authority shall not transfer, convey, assign, lease, mortgage, pledge, or otherwise encumber, or permit or suffer any transfer, conveyance, assignment, leasing, mortgage, pledge, or other encumbrance of such Project, any appurtenances thereto, any rent, revenues, income, or receipts therefrom or in connection therewith, or any of the benefits or contributions granted to it by or pursuant to this Contract, or any interest in any of the same: Provided, That the Local Authority may (1) lease dwellings and other spaces and facilities in such Project in accordance with the provisions of Sec. 203, or (2) as provided in Sec. 308, convey or otherwise dispose of any real or personal property which is determined to be excess to the needs of such Project, or (3) to the extent approved by the Government, convey or dedicate land for use as streets, alleys, or other public rights-of-way, and grant easements for the establishment, operation, and maintenance of public utilities, or (4) with the approval of the Government, convey dwelling units to occupants in form prescribed by the Government. Nothing in this Sec. 313 shall be construed as prohibiting (1) the adoption of the Bond Resolutions, or the execution and delivery of any instrument pursuant to Sec. 420, or the creation of any lien or encumbrance in any such instrument, (2) the conveyance of title to or delivery of possession of such Project pursuant to Sec. 501 or Sec. 502, or (3) the operation of any Project by any person or persons selected by the Local Authority and approved by the Government.

DONALD W. RIEGLE, JR., MICHIGAN, CHAIRMAN

ALAN CRANSTON, CALIFORNIA
PAUL S. SARBANES, MARYLAND
CHRISTOPHER J. DODD, CONNECTICUT
ALAN J. DIXON, ILLINOIS
JIM SASSER, TENNESSEE
TERRY SANFORD, NORTH CAROLINA
RICHARD C. SHELBY, ALABAMA
BOB GRAHAM, FLORIDA
TIMOTHY E. WIRTH, COLORADO
JOHN F. KERRY, MASSACHUSETTS
RICHARD H. BRYAN, NEVADA

JAKE GARN, UTAH
JOHN HEINZ, PENNSYLVANIA
ALFONSE M. D'AMATO, NEW YORK
PHIL GRAMM, TEXAS
CHRISTOPHER S. BOND, MISSOURI
CONNIE MACK, FLORIDA
WILLIAM V. ROTH, JR., DELAWARE
NANCY LANDON KASSEBAUM, KANSAS
LARRY PRESSLER, SOUTH DAKOTA

STEVEN B. HARRIS, STAFF DIRECTOR AND CHIEF COUNSEL
LAMAR SMITH, REPUBLICAN STAFF DIRECTOR AND ECONOMIST

United States Senate
COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS
WASHINGTON, DC 20510-6075

July 9, 1990

Mr. Alfred DelliBovi
Under Secretary
U.S. Department of Housing and
Urban Development
451 Seventh Street, S.W.
Washington, D.C. 20410

Dear Mr. DelliBovi:

I wish to thank you for your participation at the Subcommittee's June 29th hearing. Your testimony was insightful and will prove to be extremely helpful to the work of the Subcommittee.

During the hearing, a question emerged regarding HUD's development of performance indicators for evaluating the HOPE program to which you agreed to provide the Subcommittee with supplemental information. You stated that actual performance indicators have not yet been developed for HOPE and would not be until the program was ready to implement. However, you did agree to supply the Subcommittee with a description of the goals for the HOPE program, the types of performance indicators you had in mind when first developing the program, and the data bases from which you plan to obtain information for the indicators. (See pages 43-46 of your copy of the transcript for a discussion of this topic.)

Inasmuch as the Subcommittee is currently working to complete its report by late summer, your response is needed by July 19, 1990. If you have any problems or concerns with my request, please feel free to contact Janet Mascia of the Subcommittee's staff on 224-6094.

Once again, my appreciation for a successful hearing and your help over these many months.

Sincerely,

Bob Graham

Bob Graham
Chairman
HUD/Mod Rehab Investigation
Subcommittee

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
THE UNDER SECRETARY
WASHINGTON, D.C. 20410

July 30, 1990

Honorable Bob Graham
United States Senate
Washington, DC 20510-0903

Dear Senator Graham:

Thank you for your letter of July 9, 1990. We are delighted to have this opportunity to describe to you the four major goals of our HOPE initiative and the performance indicators that will help us evaluate the relative success of these new programs. As you stated, any set of HOPE performance indicators will require information from existing or new data bases.

The basic goals of the HOPE program include:

1. To empower people with the opportunity to manage and own their own homes and apartments;

2. To encourage people to enter the economic mainstream by removing barriers to jobs, entrepreneurship, and economic growth;

3. To provide people with better access to affordable housing and homeownership opportunities, especially for first-time homebuyers; and

4. To enable low-income people to live in dignity and independence by offering necessary support services.

These goals underscore our belief that if barriers and disincentives are reduced, individuals will choose to control their own lives and open the path to opportunity for themselves and their children. There are many ways to measure how HOPE programs might meet these goals, but we believe any set of performance indicators should include the following types of information:

-- The number of homeownership projects that move from the planning to the implementation stage each year, the number of units sold to homeowners each year, the type of units (number of bedrooms, high-rise, low-rise, formerly troubled, big city, small city), sales prices, type of financing, incomes of purchasing families.

- The number and type of applicants for HOPE grants, the number of new resident management corporations, new non-profits or non-profits new to sponsorship of homeownership conversions.

- Per unit costs of homeownership programs, amount and type of matching funds, amount of rehabilitation per unit, amount and cost of counseling, housing cost to income ratios after one, two, and five years, and delinquency and default rates of homeowners with mortgages.

- Demographic characteristics of families participating in other HOPE programs, such as Operation Bootstrap, and descriptions of services provided, cost of services, and sources of funding for services.

- The number of people moving off welfare and housing assistance into jobs in the private sector, thereby freeing up existing resources for more poor people.

- Types and quantities of services provided under Shelter Plus Care, cost of services and variation in costs by type of participant, number of individuals placed in service-supported housing, costs of housing assistance and variation by type of homeless individual.

- Number and types of new units, rental and homeownership, created by the Low Income Housing Tax Credit, including per unit costs to the Federal Treasury.

- Data on the number of new jobs created and increased investment in Enterprise Zones, especially for small businesses.

- The number of households participating in the IRA's for First-time Homebuyers program.

Our current ability to measure these basic performance indicators is low. However, we are improving data systems for existing and new programs. Given our evaluation and monitoring plans adopted by both the 1989 HUD REFORM Act and the recent House Appropriations Committee's earmark of $8 million and 40 staff years, we are confident that we can implement the HOPE programs with good data systems in place.

Other types of performance indicators that we hope to measure include:

-- Improvements to the living environment in public housing and FHA projects converted to homeownership: reduction in crime, better maintenance of units and common areas, kids staying in school, family members getting jobs and increasing income.

-- For participants in Bootstrap, completion of training, completion of educational programs, getting jobs, increasing hours of work, decreased dependence on public support.

-- For Shelter Plus Care, success of local programs in accessing services, continuity of participation of individuals in the system (i.e., not dropping out, losing contact with their case manager, ending up back in shelters or on the street), success of individuals in moving from transitional housing settings to permanent housing.

-- For Elderly Independence, success of programs in accessing services, success in retarding rate of institutionalization of users of services.

These longer-range goals or "outputs" of the programs will require comprehensive and systematic program evaluations, including contracted studies to collect and analyze data that will not be collected in the normal course of administering the programs. Our FY 1991 Budget request includes such monitoring and evaluation activities -- it is just these types of ongoing reviews of program activities that could help HUD serve Americans more effectively.

Given the interests of individuals such as yourself, committed to reducing the opportunity for fraud, waste, and abuse in HUD programs, we look forward to implementing HOPE programs in a timely and efficient manner.

Sincerely,

Alfred A. DelliBovi

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD
APPENDIX TO HENDRICKSON PREPARED STATEMENT-**Alabama**
APRIL 27, 1990 HEARING

Housing Needs Plan Seeks to Address

- Needy counties
- Special needs tenants
- Prevents loss of low-income units
- 100% low-income projects

Sequence of the Allocation Process

- Application
- Reservation
- Allocation

Set Asides

10% Nonprofit

Limits on the Amount of Credit Per Project

None specified

Competitive Selection Cycles

- March 15 - April 15, 5% nonprofit, 35% for all purposes
- June 1 - June 30, 5% nonprofit, 35% for all purposes (plus carryover)
- September 1 - September 30, 20% for all purposes (plus carryover)

Selection Thresholds

- IRS Section 42 rent restrictions
- Market and financial feasibility

Recourse for Projects Not Selected Under the Allocation Plan

May appeal in writing

Dev Fee Limits

- 20%
- 30% if developer and builder are the same

Agency Fees

$500 application fee and 4% of first year credit amount

Staffing

- 1 program director
- 1 Administrator

Process for Amending Plans

None specified

Contact Tim Singleton

Phone # (205) 261-4310

Arkansas

Housing Needs Plan Seeks to Address

Certain counties
Projects with local and federalgovernment assistance
Nonprofit sponsors
Preservation/prepayment
Placed in service in 1990

Sequence of the Allocation Process

Application
Reservation
Commitment
Allocation

Set Asides

10% Nonprofit
65% of cycles 1& 2 for
Federal Loan Fund projects
(may be revised in Cycle 2)

Limits on the Amount of Credit Per Project

Can not exceed $100,000 in Credits for each cycle
This cap may be removed in Cycle 3

Competitive Selection Cycles

Initial Approval Target Dates:

1. May 1
2. September 1

Selection Thresholds

None specified

Recourse for Projects Not Selected Under the Allocation Plan

None specified

Dev Fee Limits

20% of total costs

Agency Fees

Application:
4 units or less, $150
More than 4 units, Nonprofit,$150
More than 4 units, For-profit, $300
Reservation:$30 per unit
Allocation:$30 per unit

Staffing

1 program director
1 administrator

Process for Amending Plans

None specified

Contact Bernard Henry

Phone # (501) 682-5936

Colorado

Housing Needs Plan Seeks to Address

Counties with large percentage of low-income renter households who pay more than 30% of their incomes for rent and/or live in inadequate housing

Sequence of the Allocation Process

Reservation
Allocation

Set Asides

10% Nonprofit
20% rural areas in cycles 1&2

Limits on the Amount of Credit Per Project

No more than 12.5% of total annual credit amount

Competitive Selection Cycles

Submission Deadlines:
March 23, 1990
June 15, 1990
September 14, 1990

Selection Thresholds

None

Recourse for Projects Not Selected Under the Allocation Plan

Waiting lists. A: Those who apply after all credits reserved will be ranked if credits become available.
B: Those not meeting selection criteria will be re-reviewed after cycle 3 and after A applications, unless revised

Dev Fee Limits

Rehab: 30+ units, 15%
  Less than 30 units, 20%
New Construction: 50+ units, 10%
  Less than 50 units, 15%
Formal policy, to be published

Staffing

Full-time equivalents(FTE):
Program director, 10%
Administrator, 25%
Attorney, 5%
2 Financial analysts, 25% and 50%-75%

Agency Fees

Application fee:
  For-Profit-
    Lesser of 1% of annual credit amount or $1500
  Nonprofit-
    Lesser of 1% of annual credit amount or $750
Allocation fee:
  3% of annual credit amount, less application fee

Process for Amending Plans

None specified

Contact Linda Conway or Cheryl Waters

Phone # (303)297-7316

Florida

Housing Needs Plan Seeks to Address

Families (3+ bedrooms)
State, regional and local housing needs

Sequence of the Allocation Process

Application
Reservation
Allocation\

Set Asides

10% Nonprofit

Limits on the Amount of Credit Per Project

None

Competitive Selection Cycles

Selection Thresholds

Yes, but unclear what they are

Recourse for Projects Not Selected Under the Allocation Plan

None

Dev Fee Limits

20% of total project costs (excluding land)
Not formal,plan to publish

Agency Fees

Application fee: $350 application fee
Credit underwriting:
- 25 units or fewer, $750
- 199 units or fewer, $2,500
- 200 units or more, $3,500

Allocation fee:
- Nonprofit, 3% of first year credit amount

Staffing

1 Administrator, over 55 hours per week
2 Clerical positions, total of 60 hours per week
1 professional
Hired due to 89 Act:
2 full-time clerical positions, 1 additional

Process for Amending Plans

Contact Candy McKinney-Coates

Phone # (904)488-4197

Georgia

Housing Needs Plan Seeks to Address

Certain counties w/above- average overcrowding, lacking facilities and disproportionate cost.
High utility costs
Old, substandard housing stock
Prepayment/foreclosure of Federally assisted housing
Low-income elderly and handicapped

Sequence of the Allocation Process

Application
Reservation
Allocation

Set Asides

10% Nonprofit
13% HUD entitlement communities
5% credit fluctuations and special projects

Limits on the Amount of Credit Per Project

Nonprofit sponsor may not receive more than 25%of the non-profit set-aside
No sponsor may receive more than 10% of remaining 90% of credit authority

Competitive Selection Cycles

Application cycles:
Round 1, March 1-March 30
Round 2, July 1-July 31

Selection Thresholds

IRS Section 42
Readiness to proceed

Recourse for Projects Not Selected Under the Allocation Plan

None

Dev Fee Limits

22%
If developer and builder same, 22% / 10%
Formal policy, will publish

Agency Fees

Application fee:
  For-profit, $500
  Nonprofit, $250
Allocation fee:
  5% of first-year credit amount

Staffing

Program director, .25
Administrators, 1
Attorney, .10
Financial analyst, 3
Clerical, 1

Process for Amending Plans

Authority has the authority to amend, after public hearings

Contact Kate Little

Phone # (404)320-4840

Idaho

Housing Needs Plan Seeks to Address

Preservation
Energy reservation
Family units

Sequence of the Allocation Process

Application
Reservation
Commitment
Allocation

Set Asides

10% Nonprofit set-aside
10% FmHA 515
10% Count

Limits on the Amount of Credit Per Project

$100,000 in Application Periods 1 and 2, unless insufficient applications received to utilize the available credit. Maximum of $500,000 for current year allocations and carryover allocations not yet placed in service.

Competitive Selection Cycles

I. April 15 - 60% of credit
II. July 1 - 40% of credit
III. October 1 - All remaining credit

Selection Thresholds

None specified

Recourse for Projects Not Selected Under the Allocation Plan

None specified

Dev Fee Limits

No cap specified

Staffing

Agency Fees

1989 Fee:
Allocation fee - Greater of $500 or 4% of annual credit. $100 preliminary commitment extension fee.

Expected 1990 fees:
Application fee, $100

Process for Amending Plans

Agency may amend, upon aproval of Agency's Board of Commissioners and Governor.

Contact Laura Shaffer

Phone # (208)336-0161

Kentucky

Housing Needs Plan Seeks to Address

Certain size units (number of bedrooms) and certain types of units (elderly, handicapped or family) in certain counties.

Sequence of the Allocation Process

Application
Reservation
Allocation

Set Asides

10% Nonprofit
Cycles 1 & 2: Urban areas and rural areas will each receive 50% of the available tax credit dollar amount.

Limits on the Amount of Credit Per Project

Competitive Selection Cycles

Cycle 1: April 23 submission deadline; May 15 notification; 60% of credit
Cycle 2: June 4 submission; July 2 notification; 20% of credit
Cycle 3: September 14 submission; October 15 notification; 20% or balance of credit

Selection Thresholds

None specified

Recourse for Projects Not Selected Under the Allocation Plan

None specified

Dev Fee Limits

No cap

Agency Fees

Application fee: $50
Expected increase for 1990

Staffing

1 administrator
1/2 secretary
1/2 underwriter

Process for Amending Plans

None specified

Contact Edwin Miller

Phone # (502)564-7630

Maryland

Housing Needs Plan Seeks to Address

Geographic distribution
Local government role

Sequence of the Allocation Process

Set Asides

10% Nonprofit

Limits on the Amount of Credit Per Project

At the discretion of CDA

Competitive Selection Cycles

Round 1: Application - March 19; Review - April 17
Round 2: Application - May 7; Review - June 11
Round 3: Application - July 6; Review - August 13
Round 4: Application - September 7; Review - October 8

Selection Thresholds

Federal requirements
Readiness

Recourse for Projects Not Selected Under the Allocation Plan

Sponsors will be notified of reasons and may revise their project for next round.

Dev Fee Limits

15% of total development costs minus syndication costs

Agency Fees

Application:
For-profit, 4% of tax credit amount, 2% refunded if awarded credit
Nonprofit, $200 application and 2% of tax credit amount reservation

Staffing

Administrator: 1/8
Attorney: 1/8
Financial Analyst: 1 (Tax Credit Coordinator will be assisted by rental housing underwriters as needed); Clerical: 1/2

Process for Amending Plans

Contact Eileen Hagan

Phone # (301)974-3821

Missouri

Housing Needs Plan Seeks to Address

Preservation
Lowest income group
Extended use
Local tax-exempt organizations
*Public housing waiting lists

Sequence of the Allocation Process

Application
Reservation
Allocation

Set Asides

10% Nonprofits
10% FmHA
5% SRO for homeless, or units for handicapped or mentally ill
7.5%, 10 or fewer units

Limits on the Amount of Credit Per Project

None specified

Competitive Selection Cycles

1. Closing date: March1, 1990; 40% of credit (maximum)
2. Closing date: June 1, 1990; 40%
3. Closing date: September 1,1990; 20%

Selection Thresholds

None specified

Recourse for Projects Not Selected Under the Allocation Plan

May continue application for approval in a subsequent cycle.

Dev Fee Limits

20% of total development costs

Agency Fees

Application fee:
$15 per unit

Staffing

2 1/2 administrators

Process for Amending Plans

None specified

Contact Steve Sillimon

Phone # (816)756-3790

Nebraska

Housing Needs Plan Seeks to Address

Preservation
Family housing

Sequence of the Allocation Process

Application
Reservation
Allocation

Set Asides

10% Nonprofit
25% Projects receiving less than $100,000 in credits; half of this for FmHA
100% In-state developers or developers who previously received Credits from NIFA

Limits on the Amount of Credit Per Project

$250,000

Competitive Selection Cycles

1. Application: 4/13/90; Initial Approval: 6/1/90; 50% of total (maximum)
2. 7/13/90; 8/31/90; 50%
3. 10/12/90; 11/30/90; Remaining

Selection Thresholds

None specified

Recourse for Projects Not Selected Under the Allocation Plan

Carried over to compete in next period unless withdrawn by applicant.

Dev Fee Limits

No maximum, but 15% standard.
20% if developer and builder the same.

Agency Fees

Staffing

1 Program Director
1/2-3/4 Administrator
1/2 Clerical
1 Administrator hired due to '89 Act
No plans to contract out

Process for Amending Plans

None specified

Contact Jim Rieker

Phone # (402)477-4406

New Hampshire

Housing Needs Plan Seeks to Address

Families
Project location

Sequence of the Allocation Process

Application
Reservation
Binding Commitment
Allocation

Set Asides

10% Nonprofit

Limits on the Amount of Credit Per Project

None specified

Competitive Selection Cycles

1:Submission Deadline: February 15, 50%
2: May 15, 30%
3: August 15, 20%

Selection Thresholds

None specified

Recourse for Projects Not Selected Under the Allocation Plan

May continue application for up to one year from date of original application

Dev Fee Limits

20% of total development costs, whether developer and builder are related or unrelated.

Agency Fees

5% of reservation amount

Staffing

2 Administrators

Process for Amending Plans

NHHFA reserves right to modify

Contact Joe Erdelyi

Phone # (603)472-8623

Ohio

Housing Needs Plan Seeks to Address

1. Affordable rental units for low-income households
2. Preservation and improvement of existing private and public affordable housing units
3. Families, 3+ units
4. Permanent housing for homeless
5. Mental disabilities

Sequence of the Allocation Process

Application
Conditional reservation

Set Asides

10% Nonprofit

Limits on the Amount of Credit Per Project

$1,000,000 in credit
$150,000 from the nonprofit set-aside

Competitive Selection Cycles

Round I. Application deadline: 3/16/90; Reservations issued by 4/13
Round II. 6/1/90;7/6/90
Round III. 10/3/90; 11/16/90

Selection Thresholds

1. Section 42 of IRS Code
2. Complete application

Recourse for Projects Not Selected Under the Allocation Plan

None specified

Dev Fee Limits

No cap specified

Agency Fees

Application:
  Nonprofit, $50
  For-profit, $100
Reservation:
  Lesser of 2.5%of annual credit amount or $5,000

Staffing

Process for Amending Plans

None specified

Contact Tony Warren

Phone # (614)466-7970

Pennsylvania

Housing Needs Plan Seeks to Address

Federally assisted projects
Low-income targeting

Sequence of the Allocation Process

Application
Reservation
Allocation

Set Asides

10% Nonprofit
Region 1:
  City of Philadelphia 26.4%
  Other than Phil. 9.2%
Region 2 ,15.0%; Region 3, 9.1%; Region 4,10.8%; Region 5, 22.5%; Region 6, 7.0%

Limits on the Amount of Credit Per Project

Competitive Selection Cycles

1: Closing Date - May 15, 1990; Maximum of 40% of Credits to be allocated
2: July 1, 1990; 40%
3: Sept. 1, 1990; 20%

Selection Thresholds

Recourse for Projects Not Selected Under the Allocation Plan

Dev Fee Limits

20% of adjusted basis, exclusive of land and building acquisition

Agency Fees

Application:
  Lesser of $25/unit or $1,000
Reservation:
  For-profit, 2% of anticipated annual credit
  Nonprofit, 1% of anticipated annual credit
Allocation:
  For-profit, 2% of annual credit

Staffing

2 administrators
1 secretary
Expected to increase

Process for Amending Plans

None specified

Contact Eileen Demshock

Phone # (717)780-3800

Pennsylvania

Housing Needs Plan Seeks to Address

Federally assisted projects
Low-income targeting

Sequence of the Allocation Process

Application
Reservation
Allocation

Set Asides

10% Nonprofit
Region 1:
City of Philadelphia 26.4%
Other than Phil. 9.2%
Region 2 ,15.0%; Region 3, 9.1%; Region 4,10.6%; Region 5, 22.5%; Region 6, 7.0%

Limits on the Amount of Credit Per Project

Competitive Selection Cycles

1: Closing Date - May 15, 1990; Maximum of 40% of Credits to be allocated
2: July 1, 1990; 40%
3: Sept. 1, 1990; 20%

Selection Thresholds

Recourse for Projects Not Selected Under the Allocation Plan

Dev Fee Limits

20% of adjusted basis, exclusive of land and building acquisition

Agency Fees

Application:
Lesser of $25/unit or $1,000
Reservation:
For-profit, 2% of anticipated annual credit
Nonprofit, 1% of anticipated annual credit
Allocation:
For-profit, 2% of annual credit

Staffing

2 administrators
1 secretary
Expected to increase

Process for Amending Plans

None specified

Contact Eileen Demshock

Phone # (717)780-3800

Utah

Housing Needs Plan Seeks to Address

Below 50% of area median income
Rehab vacant urban units
New rural units
Special populations

Sequence of the Allocation Process

Set Asides

?

Limits on the Amount of Credit Per Project

Competitive Selection Cycles

1. Submission Deadline: June15, 1990; Reservation Action: July
2. Sept. 14, 1990; October
3. 30-day cycles; as required

Selection Thresholds

Recourse for Projects Not Selected Under the Allocation Plan

Appeal in writing within 15 days of decision to UHFA. Reviewed by Low-Income Housing Tax Credit Committee

Dev Fee Limits

20% of eligible basis

Staffing

1/2 Program Director
1/2 Financial Analyst (hired due to 1989 Act)

Contract outside attorney for development of annual housing needs assessment study and

Agency Fees

Initial Application Fee:
Greater of 1% of annual credit amount or $1,500 ($750 if nonprofit): Portion in excess of $1,000 may be refunded if waited-listed and Credits unavailable.

Allocation Fee:

Process for Amending Plans

As UHFA deems necessary

Contact Bill Erickson

Phone # (801)521-6950

DONALD W. RIEGLE, JR., MICHIGAN, CHAIRMAN

ALAN CRANSTON, CALIFORNIA
PAUL S. SARBANES, MARYLAND
CHRISTOPHER J. DODD, CONNECTICUT
ALAN J. DIXON, ILLINOIS
JIM SASSER, TENNESSEE
TERRY SANFORD, NORTH CAROLINA
RICHARD C. SHELBY, ALABAMA
BOB GRAHAM, FLORIDA
TIMOTHY E. WIRTH, COLORADO
JOHN F. KERRY, MASSACHUSETTS
RICHARD H. BRYAN, NEVADA

JAKE GARN, UTAH
JOHN HEINZ, PENNSYLVANIA
ALFONSE M. D'AMATO, NEW YORK
PHIL GRAMM, TEXAS
CHRISTOPHER S. BOND, MISSOURI
CONNIE MACK, FLORIDA
WILLIAM V. ROTH, JR., DELAWARE
NANCY LANDON KASSEBAUM, KANSAS
LARRY PRESSLER, SOUTH DAKOTA

STEVEN B. HARRIS, STAFF DIRECTOR AND CHIEF COUNSEL
LAMAR SMITH, REPUBLICAN STAFF DIRECTOR AND ECONOMIST

United States Senate
COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS
WASHINGTON, DC 20510-6075

May 30, 1990

Honorable Jack Kemp
Secretary
U.S. Department of Housing and Urban Development
451 Seventh Street, S.W.
Washington, D.C. 20410

Dear Secretary Kemp:

Thank you for your appearance before the HUD Investigation Subcommittee on May 16, 1990. We found your testimony enlightening and helpful to our inquiry. The subcommittee has enjoyed the cooperation of yourself and your staff in this investigation.

There are, however, a few matters which we were unable to explore with you at the hearing and request your continued cooperation. Please provide us with the following by June 8, 1990 as we are attempting to complete the work of the subcommittee in the near future:

1. As you may recall, we asked former Secretary Weaver at our first hearing about the original mission of HUD. We also learned how that mission seemed to change over the years and how it was emasculated during the term of your predecessor. Given your statement indicating that HUD has been asked to do too much, what is your understanding of the mission of HUD?

2. In reaction to many of the problems you found at HUD upon assuming office, you have suspended or terminated a number of programs, such as Title X, and are in the process of terminating others, such as co-insurance. Please provide us with a list of every program that you have suspended or terminated, are in the process of suspending or terminating, or plan in the near future to suspend or terminate, giving the date of and rationale for such action. The list we have received from your agency was incomplete.

3. We are concerned about the level of congressional review of various reports filed with Congress by your department and the Inspector General. The list of reports Congress has imposed upon your department over the years is quite lengthy. While I am certain that much of the data gathered for these reports is useful to your agency, we are interested in knowing if, in your opinion, there are any reports which must be provided Congress, the requirement for which should be modified or repealed.

4. We are also interested in a more complete list of internal studies being conducted at HUD, including those relating to programs, staffing, and internal controls, whether being conducted by staff or a consultant. We have a partial list hastily compiled by your staff at our request. However, we need to know for each study completed, currently undertaken, or planned:

(a) The nature and purpose of the study.
(b) The staff or consultant undertaking the study.
(c) Relevant dates, including RFP, beginning and completion dates.
(d) Cost or estimated cost of the study.
(e) Selection process for the consultant and rationale for use of consultant where applicable.
(f) Copies of any completed report.
(g) Description of any action taken in reaction to any recommendation made pursuant to any such report.

Thank you again for your continued cooperation.

Sincerely,

Bob Graham
Chairman

DONALD W. RIEGLE, JR., MICHIGAN, CHAIRMAN

ALAN CRANSTON, CALIFORNIA
PAUL S. SARBANES, MARYLAND
CHRISTOPHER J. DODD, CONNECTICUT
ALAN J. DIXON, ILLINOIS
JIM SASSER, TENNESSEE
TERRY SANFORD, NORTH CAROLINA
RICHARD C. SHELBY, ALABAMA
BOB GRAHAM, FLORIDA
TIMOTHY E. WIRTH, COLORADO
JOHN F. KERRY, MASSACHUSETTS
RICHARD H. BRYAN, NEVADA

JAKE GARN, UTAH
JOHN HEINZ, PENNSYLVANIA
ALFONSE M. D'AMATO, NEW YORK
PHIL GRAMM, TEXAS
CHRISTOPHER S. BOND, MISSOURI
CONNIE MACK, FLORIDA
WILLIAM V. ROTH, JR., DELAWARE
NANCY LANDON KASSEBAUM, KANSAS
LARRY PRESSLER, SOUTH DAKOTA

STEVEN B. HARRIS, STAFF DIRECTOR AND CHIEF COUNSEL
LAMAR SMITH, REPUBLICAN STAFF DIRECTOR AND ECONOMIST

United States Senate
COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS
WASHINGTON, DC 20510-6075

June 19, 1990

Honorable Jack Kemp
Secretary
U.S. Department of Housing and
Urban Development
451 Seventh Street, S.W.
Washington, D.C. 20410

Dear Secretary Kemp:

As you know, on May 30, 1990 I requested certain information regrading program terminations and studies being conducted at the department. I understand that the information requested is forthcoming, but I wish to re-emphasize our need for the information at your earliest convenience. I wish also to remind you of a few matters that were requested during the course of the hearing on May 16, 1990 for which we also need your earliest response.

You may recall that during your testimony, I expressed concern over the mission of HUD and whether HUD was asked by Congress to do too much and whether Congress is sufficiently clear in its policy direction. I requested you to provide the Subcommittee with a list of programs which fall outside the legitimate mission of HUD. I also requested that you provide the Subcommittee with your specific comments on the current housing legislation reported by the Banking Committee "in terms of how it meets your standards of clarity in transmitting, communicating what those programs or altered old programs intend to accomplish." You will find these requests on page 47 of the transcript.

You may also recall that toward the end of the hearing I stated that I wished to submit questions to you regarding the ability of HUD to carry out demand enhancement programs, such as vouchers as opposed to supply enhancement programs. Please comment on the relative ease or difficulty in administering these types of programs; how one may be more susceptible to fraud or abuse than another; the comparative complexity of these types of programs and the relative need for clarity in their creation; and how, in your view, they support or detract from the mission of the department. Please include in your response examples of the programs in these categories which support your view. I am particularly concerned about the need to address the relative needs of the various communities rather than the flow of federal funds to communities based upon a homogenous formula. You will find this request on page 82 of the transcript.

Thank you for your continued cooperation and please contact Bill Leary at 224-6166 if for some reason you will have difficulty complying with this request within the next 10 days.

Sincerely,

Bob Graham

Bob Graham, Chairman
HUD/Mod Rehab Investigation
Subcommittee

cc: Paul R. Ruppert
Senate Legislative Officer

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
THE SECRETARY
WASHINGTON, D.C. 20410-0001

September 7, 1990

Honorable Bob Graham
Chairman, HUD/MOD Rehab
  Investigation Subcommittee
United States Senate
Washington, DC 20510-6075

Bob

Dear Senator Graham:

Attached please find answers to the supplemental questions you submitted in correspondence of May 30 and June 19, 1990, stemming from my appearance before your committee on May 16, 1990.

Q. 1. As you may recall, we asked former Secretary Weaver at our first hearing about the original mission of HUD. We also learned how that mission seemed to change over the years and how it was emasculated during the term of your predecessor. Given your statement indicating that HUD has been asked to do too much, what is your understanding of the mission of HUD?

A. 1. Congress established HUD in 1965 as a major participant in the unprecedented Federal effort to eliminate poverty. In the statute establishing this Department, the Secretary was required, among other tasks, to "advise the President with respect to Federal programs and activities relating to housing and urban development [and] develop and recommend to the President policies for fostering the orderly growth and development of the Nation's urban areas..." Since the inner cities were clearly suffering from decay and poverty in the 1960s, Congress intended HUD to play an important part in the national commitment to fighting poverty.

The priorities forming HUD's agenda were designed to incorporate a careful combination of empowerment and opportunity initiatives. These goals include anti-drug initiatives, anti-poverty programs, and efforts to enforce fair housing for all. Strategies to promote homeownership, jobs, and vibrant cities are at the heart of any effort to help urban Americans escape the poverty trap, and end homelessness. The success of these priorities will help determine whether we as a society finally achieve the goals of the War on Poverty, which were outlined with great confidence and optimism when HUD was created a quarter of a century ago.

The problem has not been so much that HUD has been asked to do too much; in fact, the Administration is recommending a heightened role for HUD with new programs and new initiatives. The problem has been that this Department has sometimes been asked to do the wrong things. In some cases, HUD programs have been outside our mission, poorly targeted to people in need, or better accomplished by incentivizing the private sector.

For example, some FHA programs were not targeted to moderate and low income families and first-time homebuyers, but were used for developing golf courses and luxury housing, insuring hospitals, guaranteeing vacation home loans, or subsidizing real estate. HUD programs for economic development have also been fraught with failure and corruption. The Urban Development Action Grant (UDAG) program was a well-intentioned effort to promote economic development, but history shows it mostly subsidized existing businesses, not new ones, in poor inner city communities. Enterprise Zones are a much better way to accomplish our objective of revitalizing inner cities from the bottom up.

Similarly, HUD programs have sometimes indiscriminately constructed low income housing regardless of local market conditions and without first considering the availability of cheaper, preferable alternatives, such as vouchers and certificates and rehabilitation. Rather than empower low income people with greater choice about where to live, these programs empowered developers with fat profits and consulting fees. These government sponsored housing projects have frequently developed management, maintenance, and upkeep problems that have been nearly impossible for centralized authorities to police and remedy. It would be far better to develop a more market-driven, choice-oriented system that incentivizes behavior of landlords and tenants.

Q2. In reaction to many of the problems you found at HUD upon assuming office, you have suspended or terminated a number of programs, such as Title X, and are in the process of terminating others, such as co-insurance. Please provide us with a list of every program that you have suspended or terminated, are in the process of suspending or terminating, or plan in the near future to suspend or terminate, giving the date of and rationale for such action. The list we have received from your agency was incomplete.

A 2. TITLE X LAND DEVELOPMENTS: On June 28, 1989; following the release of two audits by the Inspector General, I announced my intention to suspend the Title X program. This was followed by the issuance of a proposed rule in the Federal Register on August 11, 1989. These actions noted the serious adverse financial condition of the program and its inability to meet its statutory goals. It was also noted that the termination action would have virtually no effect on the availability of financing for land development across the Nation. In December 1989, Section 133 of the Housing and Urban Development Reform Act of 1989 repealed Title X of the National Housing Act. On May 7, 1990, the Department issued a final rule terminating the program.

MULTIFAMILY COINSURANCE: The proposed rule to terminate coinsurance was published in the Federal Register March 27, 1990. The public comment period ended May 29, 1990. We are in the process of reviewing the public comments and are currently preparing a final rule. A decision from the Under Secretary on the actual timing of termination will be made soon.

My decision to propose termination of coinsurance was based on a determination that the coinsurance method of distributing mortgage insurance is structurally flawed and fundamentally unsound, as well as administratively infeasible. This has been demonstrated by unacceptably high default rates and resultant losses to the Federal Government because of widespread patterns of unsatisfactory underwriting. This has been further evidenced by the financial collapse of at least half a dozen undercapitalized lenders.

PRIVATE INVESTOR MORTGAGES: Due to an abnormally high claims rate, the 1989 HUD Reform Act eliminated the eligibility of private investors for insured mortgages under any of HUD's single family mortgage insurance programs, with certain exceptions referenced below. This action was implemented by Mortgagee Letter 89-31, addressed to all approved mortgagees, on December 26, 1989. The ban on investor activity was effective for mortgages insured pursuant to conditional commitments, appraisal reports or certificates of reasonable value (issued by the Department of Veterans Affairs) on or after December 15, 1989, which was the date of enactment of the Reform Act. The ban did not apply to: 1) mortgages insured under Section 203(k), HUD's Rehabilitation Mortgage Insurance program; 2) mortgages that were already insured prior to the 1989 Act and are eligible to refinance under HUD's "streamline refinance without appraisal" procedure; 3) Indian tribes; and 4) service persons who are unable to occupy the property because of duty assignments.

RETIREMENT SERVICE CENTERS (ReSC): On July 6, 1989, I announced the suspension of the ReSC program. Almost a year later, however, as the result of court decisions on April 25 and May 15, 1990, the program was reopened. The court order requires HUD to go through notice and comment rule making in order to terminate the program.

My suspension of the ReSC program was prompted by the realization that the program had already cost the government more than $119 million in direct losses, and that there were at that time ReSC mortgages in default totalling a quarter of a billion dollars. It was also clear that the program was providing no benefit to low and moderate income persons, who are and should be the principal focus of HUD programs.

Recently, the Department's Office of Policy Development and Research (PD&R) completed a national study of ReSCs that found that the insurance program is not actuarially sound. In addition, the study found that the program would need to be restructured and provide additional subsidies in order to serve low and moderate income families. In the near future, the Department intends to issue a proposed rule terminating the program.

Q. 3. We are concerned about the levels of Congressional review of various reports filed with Congress by your Department and the Inspector General. The list of reports Congress has imposed upon your Department over the years is quite lengthy. While I am certain that much of the data gathered for these reports is useful to your agency, we are interested in knowing if, in your opinion, there are any reports which must be provided to Congress, the requirement for which should be modified or repealed.

A. 3. Congress requires HUD to provide reports and analyses on new as well as existing programs. Granted, sometimes information gathered for Congressional reports is information that is already collected, but often, the data and analysis of data and program functions receive little attention from Congress. To save money and staff time for more worthwhile tasks, some reports and analyses should be discontinued. To this end, I have initiated a review of required Congressional reports to determine how we can reduce unnecessary administrative burdens and increase program integrity. We will report back to the Committee on our conclusions.

Q. 4. We are also interested in a more complete list of internal studies being conducted at HUD, including those relating to programs, staffing, and internal controls, whether being conducted by staff or a consultant. We have a partial list hastily compiled by your staff at our request. However, we need to know for each study completed, currently undertaken, or planned:

a) The nature and purpose of the study.
b) The staff or consultant undertaking the study.
c) Relevant dates, including RFP, beginning and completion dates.
d) Cost or estimated cost of the study.

e) Selection process for the consultant and rationale for use of consultant where applicable.
f) Copies of any completed report.
g) Description of any action taken in reaction to any recommendation made pursuant to any such report.

A. 4. You should have already received under separate cover an extensive listing of all recent studies undertaken by the Department.

Q. 5. Please comment on the relative ease of difficulty in administering demand enhancement programs; how one may be more susceptible to fraud or abuse than another; the comparative complexity of these types of programs and the relative need for clarity in their creation; and how, in your view, they support or detract from the mission of the Department.

A. 5. Tenant-based programs such as housing vouchers and certificates are much less susceptible to fraud, waste and abuse than are the development supply type (landlord-based) programs. Due to large scale economic interests, development or supply type programs are supported by developers/builders/project owners who are a powerful force in the housing industry. These entities are most interested in maximizing profits and do so through the use of creative financing, tax credits, tax shelters and syndication schemes. Powerful lobbying groups work on behalf of these entities and freely exercise their influence. However, this effort is a very inefficient way of serving the housing needs of very low income residents.

Tenant-based programs such as housing voucher subsidies go directly to families needing assistance. Families locate housing of their choice and operate within the housing market as would any non-subsidized family. Programs such as the housing voucher program minimize fraud, waste and abuse because the numerous middle layers for getting the assistance to the families do not exist and there are no big profits to be made by builders and owners.

Tenant-based programs such as the Section 8 certificate and housing voucher programs work well in most markets and currently assist more than one million families. Even in such tight rental markets as New York and Boston, all vouchers and certificates are put in use, often addressing very urgent housing situations of the lowest income families.

Development or supply type programs are very complex by nature. It takes a great deal more time, effort and money to develop housing than it does to subsidize standard existing housing units. To develop housing, many hurdles must be overcome such as site location and purchase; layers of local approvals must be obtained; financing put in place; lengthy construction time/delays, and marketing of units. This process is clearly cumbersome when compared with tenant-based programs.

Tenant-based programs such as housing vouchers are relatively simple to administer and provide immediate housing relief. Once income eligibility is determined, a family shops for the right unit and leases or contracts are executed. Tenant-based programs meet the intent and mission of the Department very well.

Very sincerely yours,

Jack

Jack Kemp

thanks Bob for all your interest, help & leadership in these & so many issues dealing with reforms at HUD.

JK

U.S. Department of Justice

Criminal Division

Office of the Deputy Assistant Attorney General

Washington, D.C. 20530

AUG 9 1990

The Honorable Bob Graham
Chairman
HUD/Mod Rehab Investigations Subcommittee
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510-8075

Dear Senator Graham:

Thank you for the opportunity to testify before the Mod/Rehab Investigations Subcommittee concerning the Department of Justice's accomplishments in the HUD fraud criminal enforcement arena. I hope that the following information is of further assistance to the Subcommittee.

We understand that records of the HUD Inspector General indicate that in fiscal year 1989, 250 cases were referred by HUD to either United States Attorneys or to the Federal Bureau of Investigation (FBI). We also understand that the Subcommittee would like to be apprised of the disposition of all such cases referred by HUD for the last several fiscal years. As a result of several factors, we are unable to retrieve this information from our records.

First, the cases which were referred to the Department may have been referred for pursuit of either a civil or criminal remedy. Therefore, any record of the disposition of the matter may be maintained in civil or criminal divisions of the United States Attorneys' Offices or the Civil or Criminal Divisions of the Department. Second, records of criminal investigations and cases maintained by the Department of Justice have not historically included sufficient information to identify the governmental program which was affected by the alleged crime. For example, data concerning a case prosecuted under the conspiracy or mail fraud or false statement provisions of the criminal code may be reported as a conspiracy case, but not identify the agency defrauded.

Third, after HUD refers a case to the FBI, the HUD record of that referral may become a duplicate of the FBI's record of that case. Alternatively, a HUD referral may be broken into several separate cases by either the FBI or the United States Attorney, or either of those offices might consolidate several HUD referrals into one investigation. Thus, tracking numbers of referrals through the system does not provide a meaningful measure of the Department's enforcement effort. Finally, because HUD referrals sometimes contain very little information, the United States Attorneys may not even open a file on the matter until the allegations are fleshed out. If the facts do not meet a district's prosecutive guidelines, a file may not ever be opened on the matter. For example, if it alleged that the government has suffered a small amount of financial loss, an investigation may not be pursued.

The report you received concerning Criminal Division resources devoted to HUD matters in fiscal year 1988 is only a small part of the Department's enforcement effort. The Fraud Section had an attorney working full-time in Oklahoma City beginning in 1987 on financial crimes matters, including HUD fraud. However, it is important to keep in mind that the vast majority of federal criminal cases are prosecuted by the United States Attorneys' Offices across the country. In that regard, although we are unable to report the amount of prosecutor time devoted to HUD fraud matters during any given fiscal year, we believe that prosecutorial resources are apportioned in approximately the same fashion as the FBI's investigative resources. As I testified, HUD fraud is the number two priority within the FBI's government fraud subprogram.

You also requested information on the Department of Justice's plans for bringing our HUD enforcement effort up to a "perfect 10." All 94 districts are working on their HUD caseloads to the maximum capacity possible. We are not aware that any significant matters are not receiving appropriate prosecutorial attention. For all criminal matters which are possible violations of the federal law, whether it be narcotics, crimes of violence, or white collar crime, the Department of Justice utilizes its limited resources in a fashion which will ensure that the most egregious violations receive priority attention. In the HUD area, the most egregious violations involve large dollar losses, long-term criminal conduct, and multiple violations. We believe that, consistent with the Attorney General's stated commitment to HUD fraud enforcement, all such matters are being vigorously pursued.

You also inquired as to the Department's pursuit of civil claims, and the guidance offered to HUD's General Counsel for pursuing administrative action against HUD officials. Where appropriate, the Civil Division pursues civil claims against former HUD officials and others involved in the subject programs. Several files have been opened for that purpose. At present, the Civil Division has deferred action pending completion of the criminal investigations conducted by the Criminal Division and the Independent Counsel. The Commercial Litigation Branch of the Civil Division, which has responsibility for handling HUD-related matters, has an excellent working relationship with the HUD General Counsel's Office of Program Enforcement. As with other civil fraud and public integrity matters, the Department continues to work closely with that office in pursuing civil claims against former HUD political appointees and others who have abused HUD programs.

Once again, I appreciated the opportunity to appear before your Subcommittee.

Sincerely,

Paul L Maloney

Paul L. Maloney
Deputy Assistant Attorney General
Criminal Division

○